S. HRG. No. 99-489

STATE TAXATION OF INTERSTATE COMMERCE

HEARING

BEFORE THE

SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

S. 1510

NOVEMBER 15, 1985

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STATE TAXATION OF INTERSTATE COMMERCE

FRIDAY, NOVEMBER 15, 1985

U.S. SENATE,
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT,
COMMITTEE ON FINANCE,
Washington, DC.

The subcommittee met, pursuant to notice, at 11 a.m. in room SD-215, Dirksen Senate Office Building. Hon. John H. Chafee (chairman) presiding.

Present: Senators Chafee and Mitchell.

[The press release announcing the hearing, a description of S. 1510 prepared by the Joint Committee on Taxation, and the prepared written statement of Senator Mitchell follow:]

[Press Release No. 85-088]

PRESS RELEASE

Friday, November 8, 1985.

TAXATION SUBCOMMITTEE SCHEDULES HEARING ON SENATE BILL 1510

The Senate Committee on Finance's Subcommittee on Taxation and Debt Management will review S. 1510, a bill to eliminate the restrictions on States' powers in taxing the sales in interstate commerce, at a hearing November 15, Chairman Bob Packwood (R-Oregon) announced this afternoon.

Senator Packwood said the Subcommittee on Taxation would consider the bill at a hearing scheduled to begin at 11 a.m., Friday, November 15, 1985.

The hearing is scheduled for Room SD-215 of the Dirksen Senate Office Building in Washington.

Senator Packwood said Senator John Chafee (R-Rhode Island), Chairman of the Subcommittee on Taxation and Debt Management, would preside at the hearing.

S. 1510 was introduced July 26 by Senator Mark Andrews (R-North Dakota).

The bill is designed "to eliminate restrictions on the taxing power of the States to impose, collect and administer State and local sales and use taxes on sales in interstate commerce."

SUMMARY DESCRIPTION OF S. 1510

RELATING TO

STATE TAXATION OF INTERSTATE SALES

Scheduled for a Hearing

Before the

SUBCOMMITTEE ON TAXATION AND

DEBT MANAGEMENT

of the

SENATE COMMITTEE ON FINANCE

on November 15, 1985

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

November 14, 1985

JCX-26-85

INTRODUCTION

The Subcommittee on Taxation and Debt Management of the Senate Committee on Finance has scheduled a public hearing on November 15, 1985, on S. 1510 (introduced by Senator Andrews). This bill would eliminate certain restrictions on States' powers in taxing sales in interstate commerce.

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a summary description of present law, the bill, and the issues raised by the bill.

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[1] This document may be cited as follows: Joint Committee on Taxation, Summary Description of S. 1510 Relating to State Taxation of Interstate Sales (JCX-26-85), November 14, 1985.

DESCRIPTION OF THE BILL

Present Law

A State or local government may constitutionally impose taxes on sales that occur within its jurisdiction or on the use of property within its jurisdiction. (Approximately 6,400 State and local jurisdictions impose sales and use taxes.[2]) The allowable sales tax authority of a State or local government extends to mail order sales by out-of-state vendors to residents of the State if the sale is deemed to take place within the taxing jurisdiction.[3] There are, however, limitations on the methods State and local jurisdictions may employ to collect sales and use taxes.

State and local sales and use taxes are levied on the final purchaser, but are collected primarily through the vendor. In the case of a sale by an out-of-state vendor, the U.S. Supreme Court has held that the State or local government cannot constitutionally require the vendor to collect and remit use taxes unless the vendor has a sufficient business nexus with the State.[4] In that case, the Court found that the required nexus was not present where the vendor's only connection with customers in the State was by common carriers or the United States mail.[5] The Court based this conclusion on due process considerations and on the Commerce Clause of the United States Constitution, which reserves to Congress the power to regulate and control interstate commerce.[6] The required nexus has been held to exist where the vendor arranges sales through local agents or maintains retail stores in the taxing State.

Explanation of Provision

Under the bill, any State (as well as the District of Columbia) or political subdivision of a State would be em-

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2 Advisory Commission on Intergovernmental Relations, State and Local Taxation of Interstate Mail Order Sales (preliminary draft, revised August 23, 1985), p. 8.

3 See, e.g., McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944).

4 National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois, 386 U.S. 753 (1967) (henceforth referred to as National Bellas Hess).

5 Id. at 753.

6 Id. at 760.

powered to impose a sales or use tax on any interstate sale of tangible personal property, or on the use in such State or subdivision, by a resident thereof, of tangible personal property acquired in an interstate sale. Interstate sales subject to the bill would be those in which tangible personal property, sold by a person located outside of the State or political subdivision, was delivered by common carrier or the United States Postal Service to the purchaser in the State from a point outside of the State.

The bill as introduced does not expressly authorize a State or local government to require that any out-of-state vendor collect and remit sales or use taxes relating to an interstate sale of tangible personal property to which the bill applies. However, the bill is intended to "eliminate restrictions on the power of the states to collect taxes on mail order sales."[7]

The bill would be effective on the date of enactment.

Overview of Issues

The purpose of the bill is to eliminate the disparity that arises from the constitutional limitation on the power of a State or local government to require collection and remission of a sales or use tax by an out-of-state vendor with no sales agents or retail stores in the State. Because State and local governments rely on vendors to collect and remit sales and use taxes on State residents, this constitutional limitation on the collection of these taxes generally has prevented the effective imposition of sales and use taxes on mail order sales by these out-of-state vendors. Accordingly, to the extent that purchasers can avoid sales or use tax liability by making mail order purchases from these out-of-state vendors, such vendors realize a competitive advantage in relation to in-State vendors (as well as out-of-state vendors with sales agents or retail stores in the State).

Some argue that this result is undesirable for two reasons. First, they argue that equal tax treatment of in-State and out-of-state businesses is preferable to providing one type of business with a competitive advantage based solely upon the nonpayment of State taxes. Second, they assert that State and local governments should be assisted in collecting all revenues to which they are entitled, particularly to the extent that their tax bases are affected by out-of-state mail order sales.

Others argue that Federal legislation should not be adopted addressing this issue even if the above arguments

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[7] 131 Cong. Rec. S10184 (daily ed., July 26, 1985) (statement of Sen. Andrews).

generally express the proper policy. They rely principally on two concerns: constitutionality and the administrative burden on vendors.

The constitutional issue arises under National Bellas Hess, the Supreme Court case holding that a State could not require an out-of-state mail order vendor to collect and remit sales or use taxes with respect to its sales. Some note that the Supreme Court based its decision on the fact that interstate commerce "is a domain where Congress alone has the power of regulation and control." Thus, they conclude that Federal legislation authorizing State and local governments to require collection and remission by out-of-state vendors of otherwise allowable sales or use taxes would remove the constitutional defect that the Supreme Court found. Others respond by arguing that National Bellas Hess requires a significant nexus between the out-of-state vendor and the taxing jurisdiction and that, on due process grounds, Congress may not be able constitutionally to dispense with this nexus requirement.

The issue of administrative burden relates to the fact that a mail order vendor, in order to comply with a requirement that it collect and remit sales and use taxes, presumably would have to be familiar with the tax laws in all jurisdictions with respect to which the requirement arose. This could involve significant difficulty in some cases, in light of the multiplicity of sales and use tax rules applying in different States and subdivisions thereof.

The Advisory Commission on Intergovernmental Relations (ACIR) has recommended that Federal legislation be enacted generally similar in intent to S. 1510, but with additional features designed to address these constitutional and administrative concerns. The legislation recommended by ACIR would contain a de minimis rule exempting vendors with national sales, or sales in the destination State, below a threshold dollar amount. In addition, under the recommendation, States in which there are local sales or use taxes would determine a nondiscriminatory single rate, applying to mail order sales and consisting either of the Statewide rate, or of a combined State and local rate that would apply at the option of the vendor.

STATEMENT OF SENATOR GEORGE J. MITCHELL

STATE TAXATION OF INTERSTATE SALES

There are a number of difficult questions that must be addressed before Congress enacts legislation that would empower states to impose a sales tax on out-of-state mail order sales. I am pleased this hearing has been called although I am somewhat disappointed that more notice was not given in order to permit a fuller range of views to be presented before the committee.

I have not arrived at a position on this legislation but I have heard from people in Maine on both sides of the issue and want to be aware of all the facts before voting to give states this kind of extraterritorial power.

States naturally have an interest in collecting tax revenues on mail order sales and I can understand their support for this legislation. The additional revenue is especialy important to state governments at a time when more and more fiscal burdens are being transferred from the federal to state and local level. In-state vendors are understandbly also supportive of this legislation because they believe out-of-state mail order businesses enjoy a competitive advantage by reason of the sales tax differential.

At the same time, I appreciate the very strong concerns of direct mail businesses for the burdens that would be created by this legislation. According to the Joint Committee on Taxation, approximatley 6,400 state and local jurisdictions impose sales and use taxes. I believe we can all agree that it would be intolerable to require direct mail businesses to account for all of these tax rates as the Andrews bill apparently would. Opponents of this legislation also raise compelling constituional arguments why this legislation should not be enacted.

I hope we can explore some of these issues in the hearing today. Because of the short notice on which this hearing was called, Senator Chafee has indicated that he would be willing to hold another hearing in the future to more fully explore the implications of this legislation.

Senator CHAFEE. Good morning, ladies and gentlemen.

The hearing this morning will be on Senator Andrews' bill, S. 1510, which is designed to eliminate restrictions on the ability of States to impose and collect sales and use taxes on out-of-State sales.

I think this is a very important issue, and I am delighted that Senator Andrews has introduced this legislation and is pressing it. He has taken the initiative on it.

As you know, the mail order business is booming. In the coming months I suspect that more and more busy citizens will be doing their Christmas shopping by mail. There is certainly nothing wrong with that. The convenience of this type of purchasing is good for the consumer; however, Senator Andrews is rightfully concerned that the States not lose out on revenues as a result of this trend, and he is concerned about whether the mail order business is getting unfair advantage over local merchants solely as a result of the nonpayment of sales taxes. The issue is pretty clear.

You go to a store in a town in North Dakota, and you wish to buy something, you purchase it and you pay a sales tax. You stay at home, and send in a mail order to wherever it might be, the item is mailed to your house, and you pick it up. You don't pay a sales tax.

Now there are constitutional concerns which I am certain we will hear about this morning. I look forward to learning more about all the aspects of this issue.

I welcome Senator Andrews and his testimony here, and I thank the other witnesses who have come forward on rather short notice to testify on this bill.

Now let me say this. I have had at least one Senator speak to me with concern about the shortness in time and his belief that he was not able to muster a witness, or witnesses, in opposition to the bill. I recognize that this was short time. I have told him and I will tell others here that if there are demands for further hearings—recognizing the time is short and we do not want to do anything unfair to anyone—I will hold another hearing on this.

So, Senator Andrews, we welcome you here and look forward to your testimony.

STATEMENT OF HON. MARK ANDREWS, A U.S. SENATOR FROM THE STATE OF NORTH DAKOTA

Senator ANDREWS. Thank you, Mr. Chairman.

First, let me thank you for holding this hearing at this very busy time of the year. Your assistance is especially appreciated because of the significant nature of the issue we are considering today.

S.1510, a bill that I introduced last July, eliminates restrictions on the power of the States to collect the taxes on sales in interstate commerce. I believe that this legislation is of pressing importance because it is a matter of tax reform; therefore, it should properly be part of any future tax reform legislation approved by the Congress.

But before this measure is made a part of that bill or moves through the legislative process on its own, a full and complete

public record must be established for those most affected by its provisions. Thanks to your good offices, such deliberations begin today.

Parties with opposing viewpoints have been invited to appear before this committee today. I have no doubt that they come fully armed with conflicting arguments and contradictory statistics. And that is good. That is the way we function in congressional hearings, because somewhere in the middle of the voluminous documentation you are going to hear today and in any subsequent hearings you might have, Mr. Chairman, there will be a uniform information base from which we can draft the final version of my bill.

I say this because I have not intended my bill to be the final statement on the problem we face. S. 1510 is straightforward and it is concise. It was drafted with the idea that this is a clear-cut States rights issue, and therefore we need only grant adequate authority to the States to solve the problem.

If the Congress in its wisdom decides that we should also legislate various uniform rules and rates, so be it. My overriding concern is that we must correct the situation that has grown increasingly inequitable over the past decade.

There is without a doubt inequity when some consumers pay taxes and others, for the same purchase, in the same jurisdiction, pay no tax.

All but a handful of States and localities impose sales and use taxes to fund local services, services which include education, health, and other social and public service functions. But yet out-of-State mail orders are a large and growing segment of sales on which no taxes are paid. This lack of taxation is unfair to those in need who rely on local services. It is unfair to the local school child in the State who loses the revenue to provide them needed educational opportunity. It is unfair to those taxpayers who must pay more in order to maintain services. It is unfair to those paying higher prices at local retail stores. It is unfair to local retailers who are at a competitive disadvantage because of tax levies and other contributions to the local economy.

If the ability of mail order sales to avoid State and local taxation is so inequitable, why hasn't something been done about righting this wrong? The answer, quite simply, Mr. Chairman, is that in 1967 the Supreme Court rules that mail order companies without a presence in a State do not under present law have a tax relationship with that State, and therefore do not have to collect and pay taxes in that State.

This Supreme Court case, however, left the door open to Congress, under the commerce clause, to change the law. In the *National Bellas Hess* case the Court rules that under the Constitution this is a domain where Congress alone has the power of regulation and control. So, Mr. Chairman, they put it squarely in our lap.

Let me point out that when the *Bellas Hess* ruling was handed down 18 years ago there was no need—certainly little need, if any—for the Congress to change the law. Mail order sales were a small percentage of total retail sales and local governments were not strapped for cash.

In 1985, Mr. Chairman, mail order sales have skyrocketed to $60 billion a year, over 15 percent of the national retail market. Equally important, the growing economic dependence of local govern-

ments on Washington during the last 18 years has been severely curtailed in the wake of a $200 billion annual Federal deficit. Giving the States the power to collect taxes rightfully owed to them by out-of-State mail order houses addresses both of these concerns. There would be no cost to the Federal Government in righting this wrong and it would remedy serious inequities currently borne by municipalities denied taxing authority over such commercial entities.

The response of direct marketing companies to my legislation is predictable. First, they say that this legislation will hurt the consumer. That is nonsense. Mr. Chairman. This bill will benefit society as a whole by reducing the upward pressure on local taxes. All consumers benefit from sales taxes so all should pay sales taxes.

Second, the direct marketers say that there are tremendous compliance costs. If compliance is that complex, well we will make it easy. We can provide a single rate for each State. If buyers refuse to pay the sales or use tax, then the item simply should not be sold.

Why should mail order companies, Mr. Chairman, have a different set of rules than other retailers? If it is one of the five States with no sales tax, then no tax is assessed.

Third, the direct marketing companies say that this will set a precedent for out-of-State jurisdictions. That again is nonsense. If these naysayers knew the law they would know that a mere sale constitutes the requisite minimum contact required for jurisdiction, which differs from the minimum contact required for a tax nexus.

Fourth, the mail order companies argue that they are getting nothing from the State in return for collecting taxes. That is also absurd. They are exploiting a market that otherwise would belong to retailers who pay property and other taxes in order to do business in that State.

Fifth, the direct marketers say that some of them are too small to absorb the negative impact of charging sales tax. They say they need a de minimis rule. But are there, Mr. Chairman, any retailers who are exempt because of their size from charging sales taxes? The answer is a resounding no.

The smallest retail establishment in Rhode Island or in Maine or in North Dakota pays sales taxes just as the largest department store does. Do you think start-up costs are higher for a mail order company than opening a store with clerks, and store front, and heating and all of the rest? It is doubtful. Small mail order companies quickly turn into large mail order companies because the market is so lucrative.

It is estimated that States are currently losing $1.65 billion a year in uncollected sales taxes. According to the greater North Dakota Retail Association, my State alone—one of the smaller States, Mr. Chairman—is losing as much as $30 million in revenues annually. That is $30 million we don't have to support our schools, to support our roads, to support our other programs.

In a recent Forbes magazine article, the direct marketers claim that they will go from 15 percent of the retail market to 20 percent by 1990. And as electronic shop-at-home services access through home computers gain in popularity, there is no doubt that the loss of sales tax revenue will continue its upward spiral.

Finally, Mr. Chairman, I want to mention the work of the Advisory Commission on Intergovernmental Relations in analyzing the impact of mail order sales taxation on State and local governments. The Commission, which consists of elected officials from across the country, has recommended remedial Federal legislation requiring mail order vendors to collect State tax on interstate sales.

Mr. Chairman, not only are State treasuries losing revenue at a time when the Federal Government is reducing aid of all types to the States, but local retailers are losing business to direct sellers. It is time, Mr. Chairman, to remedy these inequities.

I believe that today's hearing marks the first step toward achieving this necessary end.

And, again, I want to thank you for making this hearing possible so we can state our case.

Senator CHAFEE. Well thank you very much, Senator, for that fine statement in support of this legislation which you have—as I mentioned earlier—taken initiative on.

We are delighted that our colleague, a member of this committee, Senator Mitchell, is here. And, Senator, if you have an opening statement, now would be a good time to give it.

Senator MITCHELL. Thank you, Mr. Chairman.

I have a statement, but I will ask that it be placed in the record at the appropriate place in order to save time.

I would just say that I appreciate your willingness to hold a further hearing on this issue at which other witnesses will be permitted to testify. This is a complex issue and I recognize the force and the argument presented here today. There is, as we all know, on this and every issue, arguments on the other side as well, which I think the committee will want to carefully consider.

Senator CHAFEE. Thank you. Senator, I know that you have within your State a famous mail order establishment which I think all of us in the East anyway have personally visited. I will work with you on arranging a suitable date for the witness that you would like to have.

Senator MITCHELL. You don't have to shy from saying the name. It is L.L. Bean. And people from all over the country go there.

Senator ANDREWS. We get those catalogs. [Laughter.]

Senator MITCHELL. Darned right you do.

Senator ANDREWS. I assure you, Senator, that we shop there and we have no objections.

Senator CHAFEE. Well I will say this for L.L. Bean. I believe that they are open 24 hours a day, 365 days a year. Am I correct?

Senator ANDREWS. That's right. Stores never object to them coming to our mail box. We just want a level playing field, Senator.

Senator MITCHELL. So it is the store that never closes, typifying the consistency, patience, and good quality of Maine goods throughout the country.

Senator CHAFEE. Fine. [Laughter.]

Now that we have had a little commercial—[Laughter.]

Senator CHAFEE [continuing]. Senator Andrews, obviously this is an issue that presents problems because, as you pointed out, there are administrative burdens levied on the mail order establishment. Not only do States have sales taxes at varied rates, but they also have it on varied goods. For instance, in my State we now exempt

clothing. Formerly, we used to just exempt children's clothing; now we exempt all clothing. We have also exempted food, but that doesn't really come into this so much.

Whereas, another State may apply sales taxes to everything. Where do you draw the line?

Now the question is: How are we going to handle this from a mechanical point of view for the mail order establishment? Do you have a suggestion?

Senator ANDREWS. Yes, Mr. Chairman. I think it would be very simple because my bill is, in essence, enabling legislation. It enables the individual States to set this retail sales tax.

The committee may want to make sure that it is not leveled in excess on mail order sales over what local sales merchants pay, because certainly we do not want to discriminate against mail order merchants. But I would feel that the separate 50 States could very simply set out that the sales tax, such as in North Dakota, is a 4-percent sales tax. Other States might have a 6 percent or a 2 percent. States might decide not to do it, depending on what their people want to do within the State. But certainly I would anticipate that the 50 separate States would set their 50 separate sales taxes, and when they send goods into a State or receive an order from a State they automatically add on the percent of sales tax.

Senator CHAFEE. You referred to the Advisory Commission on Intergovernmental Relations and their view on this issue I think it has been helpful. Perhaps you recall that in that report that they did they did have a de minimis test. I think they exempted any retail establishment—mail order establishment—that had less than $12.5 million a year of sales.

Now in your presentation you indicated that, as I understood it, you would not have that de mininis rule.

Senator ANDREWS. In our bill, we did not. But in the beginning of my testimony, Mr. Chairman, I pointed out that I wanted a simple, concise, direct bill. And then I know how the legislative process works, and so do you. And we know that a committee sitting in hearings is Congress really at work.

You may well want to put in a minimum exemption. You may well want to do other things that make it easier to administer. What I wanted to do in the bill that I have introduced, and my colleague from North Dakota, Senator Burdick, the senior Senator from North Dakota, incidentally is a cosponsor to this bill, called me when I mentioned we were going to have hearings and said "Make sure you point out I am a cosponsor." Congressman Dorgan, the Congressman from North Dakota, introduced similar legislation just 2 weeks ago. So our North Dakota delegation, of course, is united on this. And we are putting forth a basic, bare bones concept that will do the job, and pointing out that if the committee wants to alter or change it in some way to make it work better, sobeit.

Senator CHAFEE. I must say that before I got into this, and actually before I heard your testimony, I had not realized how significant these mail order sales were. You said they are 15 percent of the national retail sales.

Senator ANDREWS. That is correct, Mr. Chairman. The L.L. Beans are doing a fantastic job.

Senator CHAFEE. And what did you have in dollar volume?

Senator ANDREWS. We have in dollar volume $1.65 billion in sales are mail order. In our State alone we are losing $30 million a year in sales tax. The North Dakota sales tax goes for education. So we are losing $30 million annually for education in our State because of mail order sales in North Dakota.

Senator CHAFEE. Now I may be mistaken. I think in your testimony you said $60 billion, didn't you? Did I misunderstand you?

Senator ANDREWS. Yes. $1.65 billion in taxes.

Senator CHAFEE. Oh, I see.

Senator ANDREWS. Sixty billion in sales.

Senator CHAFEE. Sixty billion in sales?

Senator ANDREWS. Yes. Sixty billion in sales.

Senator CHAFEE. In sales. And you estimate $1.65 billion in taxes lost.

Senator ANDREWS. That is right.

Senator CHAFEE. Well those are extraordinary figures.

Senator ANDREWS. And it was virtually nothing in 1967, Mr. Chairman, the time the Supreme Court decision came.

Senator CHAFEE. And from the data you have accumulated in your studies you show a curve upward in these types of sales.

Senator ANDREWS. They are estimating, Mr. Chairman, that they will increase by another 5 percent. Go from 15 percent of total retail sales to 20 percent by 1990.

Senator CHAFEE. Fine.

Senator Mitchell?

Senator MITCHELL. Well thank you, Mr. Chairman. I would merely comment that you have used 50 States as the number of jurisdictions which impose sales taxes, suggesting that there would be——

Senator ANDREWS. Not all of them.

Senator MITCHELL. I meant Senator Chafee, in his comments, 50 States that impose taxes, or most of them.

Senator CHAFEE. I said most of them.

Senator MITCHELL. Yes.

Senator CHAFEE. Senator Andrews in his testimony I think said 46 States have sales taxes.

Senator MITCHELL. Forty-six States, right. I would point out that in a staff report prepared by the Joint Committee on Taxation it identifies 6,400 States and local jurisdictions in this country which impose sales and use tax. The number is not 46; it is 6,400 jurisdictions. So the task that a direct mail seller would have would be far more complex than evaluating merely 46 sets of legislative standards. It would be evaluating 6,400. And I think therefore is something that we will have to look at very carefully on this matter.

Senator CHAFEE. Yes.

Senator MITCHELL. Could I just ask, Senator, how was the figure of $30 million in loss of revenue to the State of North Dakota arrived at? What is the basis for that figure?

Senator ANDREWS. The basis for that story is our State chamber of commerce estimating the amount of retail sales that catalog firms do in the State and the amount of tax that would be derived from those sales, had tax been paid.

Senator MITCHELL. Since, of course, there are no records maintained of this type, would you have the chamber submit to the committee a written statement——

Senator ANDREWS. We would be glad to get the back up statement for that, Senator, and we will provide that rapidly for the record.

Senator MITCHELL. I thank the Senator.

Senator ANDREWS. Thank you very much.

[The statement prepared by the North Dakota Retail Association follows:]

PREPARED BY: North Dakota Retail Association
206½ North Sixth
Bismarck, North Dakota 58501

COMPUTATION TO ESTIMATE LOSS OF SALES TAX REVENUE FROM SALES BY OUTSTATE CATALOG SELLERS:

Outstate catalog sellers (Direct Marketers) have claimed publicly in May, 1984, that they possess 15% of the retail market.

Assume, also, that North Dakota's four percent (4%) sales tax rate and annual tax collection of $195 million dollars reflect total taxable sales in our state of $4.875 billion dollars a year.

If that $4.875 billion dollars is 85% of the total taxable retail market, the total market may be as much as $5.735 billion dollars. The four percent (4%) sales tax loss on the untaxed $860.294 million dollars is $34,411,760 dollars annually.

Senator CHAFEE. Well thank you very much, Senator, for alerting us to this matter, which I must say I had not spent much time on before your legislation came before us.

Now we would be delighted to have you join us on the podium here if you would like, or you may have other business.

Senator ANDREWS. I am interested: I want to learn, too.

Senator CHAFEE. All right. Fine. Why don't you come and join us.

The next witness is a panel consisting of David Nething, majority leader of the North Dakota State Senate; James L. Martin, legislative counsel, National Governors Association; Alan Glazer, president, Bedford Fair Industries of Mt. Kisco, NY; Arthur Wheeler, president of the North Dakota Retail Association; and J. Basil Wisner, deputy comptroller of the State of Maryland.

Gentlemen, please take your seats there and we will have statements from each of you.

Mr. Nething, you are?

Mr. NETHING. I am a director of government affairs for the Direct Marketing Association here with Mr. Glazer.

Senator CHAFEE. I see. All right. Fine.

Well, we welcome you all, gentlemen. And if you could restrict your statements to not more than 5 minutes, we would appreciate it. Then there will be questions. Many of you have submitted written statements, which will be included in the record, so don't feel that you have to read each of them. You can extrapolate.

Senator Nething, we welcome you here. Please proceed.

STATEMENT OF HON. DAVID E. NETHING, MAJORITY LEADER, NORTH DAKOTA STATE SENATE, AND PRESIDENT-ELECT, NATIONAL CONFERENCE OF STATE LEGISLATURES, JAMESTOWN, ND

Mr. NETHING. Thank you, Mr. Chairman, and members of the committee. We appreciate the opportunity to address you today on an issue of concern to State legislators across the country. My name is David Nething. I serve as the majority leader of the North Dakota Senate. I also serve for 15 more days as the president-elect of the National Conference of State Legislatures, at which time I will become president.

In 1983, our organization again revisited the issue of *National Bellas Hess* at the time the Advisory Commission on Intergovernmental Relations was studying the matter. Senator David Durenberger, Senator William Roth, and Senator James Sasser are members of ACIR representing the United States Senate. I am one of the State legislative representatives and have been since August 1982.

Before presenting NCSL's concerns, I would like to present you with copies of the ACIR policy position which was adopted earlier this year, along with some background information, and I would ask that you make it part of your record for this hearing.

[The information follows:]

The Advisory Commission on Intergovernmental Relations

Commission Recommendation 09/20/85

Commission Recommendation Corrective Federal Legislation to Enable States to Enforce Use Tax Collection

The Commission recognizes that significant changes have occurred in the composition and technology of the retail sales market in the eighteen years since National Bellas Hess. It is also keenly aware of the need to equalize the competitive position of in-state and out-of-state vendors and to safeguard state sales and use tax bases and revenues. To achieve these aims, the Commission recommends that Congress enact legislation that would negate the National Bellas Hess decision by requiring mail order vendors to collect a state's use tax on interstate sales delivered in that state, if the mail order vendor engages in regular or systematic solicitation of sales in that state through catalogs, advertising, or other means.

To relieve the compliance cost burden on small businesses, the legislation should contain a de minimis rule, exempting vendors with national sales and/or sales in the destination state below a specified threshold dollar amount. The de minimis figure(s) should be determined by Congress, but should be no less than $12.5 million in gross sales, indexed annually to the Consumer Price Index to account for inflation.

To minimize compliance costs for firms operating in multiple jurisdictions, states in which there are local sales and use taxes should determine a non-discriminatory single rate, either (a) the state rate only or (b) a combined state and local rate that the out-of-state seller may elect to charge in lieu of applying the combined state and local rates for all jurisdictions which are the destinations of the sales.

To protect firms from indeterminate tax liabilities for past sales, no state should be allowed to collect any additional taxes based solely on retroactive application of any Congressionally authorized modification of nexus standards.

ADVISORY
COMMISSION ON INTERGOVERNMENTAL RELATIONS
WASHINGTON D C 20575

August 26, 1985

MEMORANDUM

TO: Members of the Advisory Commission on Intergovernmental Relations

FROM: John Shannon
Executive Director JS

SUBJECT: State and Local Taxation of Interstate Mail Order Sales

This policy report deals with judicially imposed restrictions on the ability of states to collect sales and use taxes from out-of-state vendors (particularly mail order firms) on sales made into their jurisdictions.

This report sets forth four alternative policy positions ranging from retention of the status quo to a most drastic departure from existing practice--a federal tax on interstate sales. These recommendations are set forth in Chapter I, pages 19-32.

To facilitate Commission consideration of this highly controversial issue, the staff has prepared a short Executive Summary that can be found right after this memorandum and a statement of major study findings and conclusions (Chapter I, pages 13-18).

The entire study was sent under separate cover to each Commission member before the June Commission meeting. A slightly revised edition is now available; Commission members who want one, should call Mrs. Phillips (202/653-5540).

EXECUTIVE SUMMARY
STATE TAXATION OF INTERSTATE MAIL ORDER SALES

The Problem--Enforcement of the Sales/Use Tax Law

State tax authorities are becoming increasingly concerned about their inability to collect the sales/use tax in a growing number of cases in which their residents purchase goods from out-of-state mail order firms. Their enforcement concern is illustrated by the following hypothetical example in which three Wisconsin consumers purchased camping equipment for $1,000.

> Consumer A buys at a local retail store where the firm collects $50 in Wisconsin sales tax and remits it to Madison.
>
> Consumer B orders from the Sears, Roebuck catalog headquarters in Chicago. Because Sears also has outlets in Wisconsin (and hence a business presence), that firm collects and remits $50 in use tax.
>
> Consumer C buys from a catalog seller in Maine which has no business location or facilities in Wisconsin. He pays neither sales nor use tax.

The point must be emphasized that Consumer C is legally liable for the payment of the Wisconsin use tax on the equipment he purchased and had sent into the state. The only issue is how to best enforce the sales/use tax law.

State sales tax administrators are currently unable to collect the use tax owed on out-of-state mail order sales because (a) the Supreme Court ruled in National Bellas Hess (1967) that out-of-state vendors with no business presence in a state could not be required to collect the use tax and (b) mail order firms generally are not willing to provide the necessary transaction data that would enable state tax authorities to collect the use tax directly from the customers.

The Proposed Solution--Federal Legislation

Most state tax authorities support a proposal for federal legislation that would negate National Bellas Hess and require out-of-state vendors to collect the use tax on their interstate sales if (a) they ship goods into the destination state and (b) the seller engages in regular or systematic solicitation of sales in the states, thereby competing in the consumer market of the destination state. Because of the increase in the use of 800 numbers, sales through computers, television ads, and specialty catalogs, state tax administrators view these mail order purchases as posing increasingly serious equity and tax erosion problems.

Controverted Issues

The Constitutional Issue--Spokesmen for mail order firms argue that a congressional requirement that would have them collect the use tax on their interstate sales would be unconstitutional and they cite the National Bellas Hess decision in support of their position. State Rejoinder--Congress does have the constitutional power to require mail order firms to collect the use tax and the courts would not now sustain a legal challenge to this type of legislation.

The Benefit Issue--Unlike the local merchants, mail order representatives argue that they receive no benefits from the services financed by the sales/use tax collections. State Rejoinder--State tax authorities argue that because firms merely serve as collectors of the sales/use taxes, the purchasers are the real beneficiaries of the services financed by sales and use tax receipts. Thus, in the case cited above, consumers A, B, and C all benefit from the services underwritten by the sales/use tax and they all should be required to pay the Wisconsin tax.

Heavy Compliance Burdens--The mail order firms would be forced to shoulder extraordinary compliance burdens if they are required to comply with the differing tax code provisions of 45 states and 7,000 local governments that are now imposing sales taxes. State Rejoinder--It is conceded that small firms would confront heavy compliance burdens if legislation fails to grant reasonable relief such as a de minimis rule that would exempt small operators from the use tax collection requirement. A uniform rule (a single rate for each state) could protect mail order firms from having to comply with the collection provisions of 7,000 local sales taxes.

The Competitive Issue--Mail order representatives argue that collecting the use tax on all interstate sales would be detrimental to their interest by weakening their competitive position in relation to local merchants. State Rejoinder--Mail order firms should not be allowed to enjoy an apparent competitive advantage (4-1/2% average nationwide) over the hundred of thousands of in-state merchants who cannot legally avoid the collection of the sales/use tax.

Federalism Issue--Some students of federalism argue that Congress should not be called in to collect a tax that states cannot collect themselves. Thus, this type of federal intervention, if carried to its logical conclusion, would have the national government take over all of the sales and use tax collection responsibility and disburse the tax receipts to the states. State Rejoinder--Congressional help in this matter would not represent an ominous intervention, rather it would simply restore the situation that existed prior to the Supreme Court decision. They also argue that this act of intergovernmental comity would be especially timely now that the federal government is cutting back on federal grants to the states and threatening to do away with other forms of indirect assistance--the deductibility of state and local

taxes and the tax-exempt status of state and local bonds issued for private purposes.

Major Findings and Alternative Policy Recommendations

The major study findings are set forth in Chapter 1 on pages 13 to 18 and four alternative policy recommendations are set forth as follows:

Alternative Recommendation #1--Affirm the Status Quo (Chapter I, page 19).

Alternative Recommendation #2--State-Initiated Litigation to Reduce Use Tax Evasion (Chapter I, page 22).

Alternative Recommendation #3--Corrective Federal Legislation to Enable State Tax Enforcement of Use Tax Collections (Chapter I, page 25).

Alternative Recommendation #4--A Direct Federal Tax on Interstate Mail Order Sales (Chapter I, page 31).

ADVISORY
COMMISSION ON INTERGOVERNMENTAL RELATIONS
WASHINGTON, D.C. 20575

PRELIMINARY DRAFT

STATE AND LOCAL TAXATION OF INTERSTATE MAIL ORDER SALES

Advisory Commission on
Intergovernmental Relations
Washington, D.C. 20575
Revised August 23, 1985

STATE AND LOCAL TAXATION OF INTERSTATE MAIL ORDER SALES

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CHAPTER I. OVERVIEW

This study seeks to answer the policy question: Should out-of-state mail order firms be required to collect state sales or use taxes on the sale of goods and services across state lines if those sellers actively and regularly solicit business in the taxing state by distributing catalogs or through other means of advertising? If so, what is the most appropriate way to do so?

The issue of taxation of interstate sales of all kinds, but particularly mail order sales, has surfaced at frequent intervals in the last 25 years in response to (a) growing revenue needs of state governments, (b) state fears of erosion of the sales and use tax base as buyers shift to untaxed out-of-state vendors and (c) concern about the competitive position of intrastate vendors. This study is restricted to mail order sales and does not attempt to address the more difficult and legally more complex issue of border sales.

Historical Background

Proposals to enact federal legislation governing the nexus (or business presence) requirement for the state sales and use tax have been made almost every year since 1965. If remedial legislation on the tax collection obligation of mail order sellers were enacted at this time, state revenue officers would ask that it restore states to the situation that existed prior to a 1967 Supreme Court decision, National Bellas Hess v. Illinois Department of Revenue[1]. That decision held that a state could not require an out-of-state mail order vendor to collect and remit the state's sales or use tax on sales made to customers in that state if

that firm did not meet some minimum linkage or nexus test in the taxing state.

Prior to the **National Bellas Hess** decision, collection from non-resident firms was sometimes enforced through state courts, although the ability to do so varied from state to state. The State of Illinois attempted to enforce the collection requirement with National Bellas Hess Inc., a Missouri firm, in Cook County Circuit Court. The State won a judgment, which would have been enforced through the Illinois Secretary of State, but the firm appealed to the Illinois Supreme Court and thence to the U.S. Supreme Court on grounds of violation of due process and interstate commerce. In the Supreme Court, National Bellas Hess was judged to have insufficient linkage, or nexus, with the Illinois market to justify the state of Illinois requiring the firm to collect the tax from its customers and remit it to Illinois. Thus, Illinois (and other states) were no longer permitted to enforce the use tax on interstate mail-order firms such as Bellas Hess, unless the defendant firm met the nexus test. The minimum and maximum limits of the nexus test are not, however, clearly spelled out in the majority decision, which concludes with a reminder[1] to Congress of its responsibility to regulate interstate commerce.

Vendor Collection

Sales and use taxes are levied on the final purchaser but collected primarily through the vendor. For in-state sales, the fact that the sales tax normally rests on the purchaser but is collected by the vendor presents no serious problems. For many interstate sales, the state is also able to collect use tax through one of following methods:

1) If the vendor has an adequate "nexus" i.e., business location or other identifiable linkage which meets the nexus test -- warehouses, retail outlets, salesmen, offices, service facilities, etc.-- in the state, the state is able to require that the firm collect either sales or use tax, usually the latter.

2) Out-of-state purchases of automobiles are usually subject to collection of sales or use taxes because the purchaser must pay it in order to register the vehicle in the state.[2]

3) At least part of the use tax on business purchases from out-of-state vendors can be collected from the business purchaser through normal channels (monthly or quarterly sales tax returns) or on audit by state tax authorities if the purchaser is registered for sales tax purposes.

4) Reciprocal collection cooperative agreements provide some enforcement of the use tax collection, although this is the least common method, particularly since National Bellas Hess.

Purchases on which use tax is most likely to escape collection include mail order and direct marketing interstate sales, border sales, and some part of taxable business-to-business sales. It is the first of

these categories, and some parts of the third category, which are the concern of this study.

Recognizing that the obligation to collect sales and use taxes is not costless to the vendor, 25 sales tax states now offer some kind of collection cost allowance. While Michigan only provides a flat $50, Kentucky only allows 1.25% up to $1000 in tax, and Utah only gives a breakage allowance, all of the other 22 offer a percentage of tax collected, ranging from 1% in 5 states to 3.3% in Colorado. A small number of states have a sliding scale percentage with a larger allowance for small firms.[3]

Industry Size and Potential for Growth

The volume of revenue lost and the competitive effects on in-state firms from these non-taxed interstate purchases depend on the size of the mail order and direct marketing industry. It is very difficult to determine precisely how large this volume of sales is, because mail order and direct marketing are not an "industry" but a branch of retail trade, with many small firms and high entry and exit from the field, a general characteristic of retail trade. Estimates of sales by mail order firms range from the Census' very conservative $11.1 billion in 1982[4] to the industry's own figures of sales well in excess of $100 billion in 1984.[5] Census data only includes those firms for which mail order is the primary industry (SIC 5961); the Small Business Administration data base suggests that at least half of mail order sales is done by firms with a primary classification other than mail order sales, mostly retail firms with a "sideline" in mail order. The "big three" -- Sears, Penneys, and Ward's -- would be found, for example, in a different SIC category since

operation of general merchandise stores is their primary business and generates far more of their sales volume than mail order.

One rather careful estimate for 1983 sets consumer purchases of products via mail order at $30.8 billion and business purchases of products and services by mail at $28 billion.[6] A portion of the business purchases is subject to use tax, much of which goes uncollected (we use an estimate of 25%). The highest sales figures for the industry (those in the $100 billion plus range) are often based on multiples of advertising methods or other shortcut methods, and usually include such nontaxable categories as services and charitable fund-raising by direct mail. Thus, the intermediate estimate of $37.8 billion in potentially taxable mail order sales for 1983, or about $44.9 billion in 1985 based on average recent growth rates of mail order sales, is used as the starting point for revenue estimates. This figure is somewhat closer to the range suggested by Census when account is taken of industries with a secondary business in mail order, business mail order purchases, and a three- year projection from 1982 to 1985, all of which would give an adjusted Census figure of $36 billion.

Mail order sales have been growing somewhat more rapidly than GNP or total retail sales -- at a rate of 9% a year in the Census estimates for 1972-1982, and currently at a rate of 8-12% a year according to intermediate estimates. As a result of recent technological changes in communications, some observers expect sales by this method to grow rapidly in the near future. These technologies include the growing use of toll-free (800) sales through newspaper, magazine and television ads; the infant computer marketing via home computer linkup; and new developments

such as computer terminal "catalogs" for direct sales placed in factory cafeterias, supermarkets, and other strategic locations. Other observers are less sanguine about industry prospects, especially after a number of catalog sellers failed during the 1982 recession. Because of the difficulty of forecasting the industry's future, we are limiting tax revenue estimates to the near term.

Effects of Industry Growth on Competition and Tax Revenue

The side effects of past and prospective growth in mail order sales are twofold; the impact of tax-free mail order competition on in-state retailers, and the potential tax revenue loss.

Competitive Effects. The consumer's decision to purchase from an out-of-state firm may be motivated by many factors. Avoidance or evasion of the sales or use tax is not always the primary or even a major reason for choosing mail order rather than a local retailer.[7] However, price differentials because of sales taxes can sometimes create a marginal advantage for an out-of-state supplier who fails to meet the nexus test and thus is not required to collect use taxes. This tax advantage is particularly important for "big ticket" items -- furniture, recreational equipment, computers, and audio equipment.

Consider a simple example. A purchaser of $1000 worth of camping equipment, who resides in a state with a 5% sales and use tax, might consider three suppliers. Firm A is an in-state firm who must collect 5% ($50) in sales tax. Firm B is a large mail-order firm, such as Sears, which meets the nexus requirement and must collect $50 in use tax. Firm C is a mail-order firm in another state with no nexus. By purchasing

from Firm C, the buyer can avoid the sales tax and evade the use tax. Other things being equal, the purchaser will lean toward Firm C.

An out-of-state seller's tax-based competitive advantage has both efficiency and equity aspects. Economic efficiency implies that consumers should be choosing suppliers on the basis of total cost and benefits, taking into account transactions costs, service, price, etc., but should not be induced to select a supplier by tax differences. Tax advantages for out-of-state vendors distort consumer decisions and encourage expansion of the mail-order industry relative to other types of retail suppliers. In equity terms, the amount of sales and use tax paid by a particular consumer should not depend on his or her choice between an in-state retailer and an out-of-state mail-order supplier.

State and Local Government Revenue Losses. Even if evading the sales tax is not always the primary motive for preferring out-of-state mail order to local retail outlets, the effect on the tax base and sales tax revenue is the same -- a loss of revenue because if the state's inability to collect the use tax. Chapter III develops estimates of revenue losses to state governments (and those local sales and use taxes collected by all county or municipal governments in a state) for 1985, based on the Fishman sales data with careful adjustments for exempt items and other corrections, that lie in the $1.4 to $1.5 billion range. Even after allowing for vendors that meet nexus in multiple states, or exclusion of some sellers by a de minimis rule, total sales and use tax revenue losses in excess of $1 billion seem well within the realm of probability.[8]

Growing Dependence on Sales Taxes

Growing state reliance on sales and use taxes has compounded the amount of revenue loss from interstate mail order sales. Sales and use taxes constitute 24% of all tax revenues for state and local governments in 1982, up from 19% since 1967 (the year of the National Bellas Hess decision).[9] In the last five years the number of local jurisdictions levying sales and use taxes has risen by 43%, from 4462 to 6397. In addition, 29 states raised their sales tax rate during that period, while only one state reduced its rate.

Compliance Costs--The Business Side of the Story

Firms not now obligated to collect the tax rest their economic arguments against collection requirements primarily on compliance costs. If local as well as state use taxes are to be collected (both are collected by mail order firms meeting current nexus standards), there are nearly 7000 jurisdictions to deal with; even for state taxes alone, or a combined state-local tax, there are 46 jurisdictions. In addition to rate differences, exempt items and buyers vary greatly from state to state - a particular problem for sales into food and clothing-exemption states, or to potentially exempt buyers (e.g., charitable organizations in many states), or to business firms.

Mail order firms argue that an adequate determination of the sales tax is more difficult in mail order purchases without the physical presence of the customer to resolve borderline cases of exemptions. The cash mail order customer must determine the amount of tax to add.

The growing volume of credit purchases presents a much less serious problem.

Compliance costs appear to be a particularly serious problem for the numerous small firms, who do not make the bulk of the sales in mail order and direct marketing. The definition of "small" is a critical component of any proposed legislation. A Philadelphia firm which sells sales and use tax computer software estimates that annual sales of $5 million would be a threshold level for use of their product, a measure which ties size to use of cost-saving tax compliance technology.[10] The Small Business Administration develops size standards for various industries which define maximum sales levels below which firms are eligible for the services of the SBA. For mail order firms (SIC 5961) the 1984 threshold sales volume was set at $12.5 million.

Large firms are more likely to meet the business presence test in more than one jurisdiction and therefore have greater familiarity with complying with multiple sales and use tax requirements than smaller firms. Few firms, however, are presently involved in collecting taxes for a large number of states. A rough measure of those who meet the nexus requirement in more than one state is the number of multi-establishment firms. Census data indicates that in 1982, only 18 of 5858 firms which list mail order as their primary classification operated five or more establishments[11]. (No comparable firm/establishment data are available for firms whose secondary industrial classification is mail order.)

Several possible solutions to the compliance cost problem have been proposed. These include a national mail order tax on interstate mail order sales at a single uniform rate, to be remitted to the states;

limiting collection to state sales and use taxes only, reducing the number of rates to 46; universal collection cost allowances; taxation of mail order sales by state of origin rather than state of destination; or exemption of small firms through a de minimis rule. No action on taxation of interstate mail order sales should be undertaken without addressing the issue of compliance costs for small firms.

Congressional Inaction--The Corporate Income Tax Linkage Problem

For twenty-five years, state efforts to broaden the array of firms liable to collect state sales and use taxes have been effectively countered by business efforts to restrict the jurisdictional reach of the state corporate income tax with respect to multistate and multinational corporations. In a series of hearings on these two interrelated but separable issues, the early discussions focused on the sales and use tax. Recent hearings have given more time and attention to worldwide unitary corporate income taxation. During the same period, the jurisdictional reach of the use tax has actually been narrowed by several Supreme Court decisions, of which **National Bellas Hess** in 1967 was the most significant.

As the national government attempts to devolve some of its responsibilities to the states, and as federal aid becomes a smaller fraction of state and local resources, it is particularly appropriate to reexamine the role of the national government in restricting the ability of states to raise revenue from the sales and use tax - a traditional mainstay of the state government tax structure in 46 of 51 jurisdictions.

Previous Commission Action

Although this analysis is the first thorough study that ACIR has done of the interstate mail order use tax issue, the Commission did adopt a recommendation on the topic in 1974 as a rather incidental result of the Local Revenue Diversification study.[11] That recommendation called for federal legislation to ease compliance problems for out-of-state vendors and to protect in-state businesses from tax-free competitors, by authorizing states to collect sales taxes on firms making sales in states in which they have no place of business. The broad 1974 recommendation, unlike the one in this study, would imply that border firms would have a collection obligation as well as mail-order firms. (The text of this previous recommendation is reproduced in Appendix B of this study.) The current study and recommendation are limited to mail order and direct marketing sales.

In 1981, the Commission considered the issue of unitary state taxation of corporate income.[12] Recommendations pertaining to the jurisdictional reach of the sales and use tax were presented to the Commission for consideration in conjunction with that study. However, no Commission action was taken on that issue. (That proposed recommendation is also included in Appendix B.)

Plan of the Study

Chapter II identifies the legal issues involved, particularly from a federalism perspective, and reviews the judicial history of the issue and describes previous efforts to address it through legislative

means. Chapter III of this study sets forth the economic considerations surrounding the issue of requiring out-of-state mail order vendors to collect and remit use tax. These considerations include a review of relevant features of the sales and use tax, the problem of base erosion, the revenue implications of taxing or not taxing interstate mail order sales, competitive effects, and compliance costs for multistate sellers. Chapter IV identifies some of the major constituencies with a stake in this issue and reviews their positions. Chapter V examines the implications of three proposed solutions -- a judicial solution, cooperative efforts, or Congressional action -- and the issues relevant to each approach. Four appendices present the results of two ACIR surveys of state revenue officials, the 1974 ACIR recommendation and the recommendation proposed (but not adopted) in 1981, two bills introduced in Congress to resolve the interstate sales and use tax issue, and the 1967 Supreme Court decision in **National Bellas Hess**.

Findings and Policy Conclusions

Among the major findings and policy conclusions of this study are the following:

1. Minimum Linkage -- the Nexus Test. The requirement that a tax collection obligation could be imposed only on out-of-state firms which meet some test of some minimum linkage (business presence test) with the taxing state was established in the majority opinion in the 1967 National Bellas Hess decision. Since the decision was made in an era of more traditional sales methods, the definition of nexus should be reviewed in the light of the increased use of more sophisticated means of communication requiring no physical presence, such as direct computer access, specialty catalogs and computerized selection of mailing lists, 800 toll-free numbers and television advertising of direct marketing sales. Catalog selling, the issue in National Bellas Hess, is now only one of a number of sales methods not requiring a physical presence or direct face-to-face contact with the buyer.

2. Available Remedies. Past Supreme Court decisions limit the ability of states to resolve this issue solely by means of voluntary compliance or interstate cooperation in enforcement, using state courts to seek judgments against non-complying firms, as the State of Illinois attempted to do in the 1967 case. Such methods would at best only bring a very limited additional portion of interstate mail order sales into the taxable domain, given the existing Court decisions which limit the reach of interstate cooperation to firms meeting current nexus standards. Litigation by states in federal courts to broaden nexus and to consider

new forms of communication and new sales methods as a basis for reconsideration and redefinition of nexus is a possible remedy, although it too may only address a portion of mail order sales. Federal legislation restoring the pre-1967 situation, or imposing a national tax on currently untaxed interstate mail order sales, is a more inclusive but also more intrusive potential remedy than either cooperative or judicial approaches.

3. The Interstate Commerce and Due Process Clauses. Legal opinion shows some division on whether Congress is constitutionally able to overrule the Supreme Court and modify or discard the narrow nexus standard in **National Bellas Hess**. Attorneys for mail order interests contend that Congress is powerless to act; they argue that, because the majority decision rested on the due process clause of the Constitution, the clearly delineated authority of Congress to regulate interstate commerce does not extend to overturning a due process decision. Lawyers representing state interests do not feel that due process considerations constitute an insurmountable barrier to Congressional action. They point out that the **National Bellas Hess** decision was based primarily on commerce clause concerns and that the due process clause has been described by the Court as "an elastic concept". In addition, they point out that the jurisdictional standards presently governing state corporate income taxes came about in exactly that fashion, i.e., they are the result of Congressional action in 1959 to overrule a Supreme Court decision that same year (**Northwestern States Portland Cement Co. v. Minnesota**, 358 U.S. 450). Finally, they suggest that Congress' power in due process, spelled out in the Fourteenth Amendment, has often

been used to expand due process; it is not clear that power could not also be used to restrict due process, especially in a federalism rather than a civil rights context.

4. Methods of Enforcement. If the nexus standards were made sufficiently inclusive through federal legislation, so that a substantial number of nonresident mail order firms could be required to comply with the use tax collection requirement, several methods of enforcement are feasible. The weakest but also least intrusive method is to return to the method of enforcement attempted in National Bellas Hess -- voluntary cooperation between the vendor's state and the purchaser's state. A stronger method is for Congress to authorize multistate reciprocal agreements to enforce collection of the use tax. A third, far more effective method, but one that would also substantially increase federal participation, is to authorize enforcement through the federal court system. Finally, some industry sources have suggested that compliance costs might be minimized with a Federal mail-order sales tax on all sales outside the state(s) in which the firm meets current nexus standards. The funds could then be distributed among the states on the basis of a criterion such as population size, share of total retail sales, or personal income. While this last solution involves the greatest federal intrusion, it is also the enforcement method with the lowest collection/compliance costs for firms.

5. Economic Effects: Competitive Fairness and Tax Revenue Losses. Economic theory predicts that failure to impose sales and use taxes on nonresident mail order firms would affect sales of competing in-state firms, whose sales are subject to sales tax, as well as sales of

competing mail order firms which meet the nexus test and must collect use tax. The National Bellas Hess decision may in fact be partly responsible for stimulating the growth of the mail-order industry by creating tax incentives to expand interstate mail order selling.

The large volume and rapid past growth of interstate mail order sales, much of which escapes state and local use taxes, have generated substantial losses of state and local sales and use tax revenue. Estimated revenue losses from the inability to collect sales and use tax on most mail order and direct marketing sales in 1985 range from $1.4 billion to $1.6 billion.

6. Compliance Costs and Double Taxation. Business firms engaged in interstate mail order sales object to proposals to require them to collect and remit the use tax, because of the high compliance costs associated with filing in multiple jurisdictions. These firms also argue that nonuniform state credits and refunds for taxes paid to other states can lead to double taxation. Although coverage and other aspects still vary greatly from state to state, in the last two decades states have made progress in making their sales and use taxes more uniform with respect to providing credit and/or refunds for sales and use taxes paid to other states. Empirical evidence suggests that compliance costs are particularly a concern for small firms.

Possible approaches to addressing compliance costs include 1) a de minimis rule (exempting firms with sales below a certain threshold), 2) a uniform combined state and local rate for each state, 3) allowing collection of state use taxes only (not local), or 4) wider state use of percentage allowances to cover collection costs. If a de minimis rule is

adopted, the choice of an appropriate threshold would have to be based on carefully weighing the revenue and competitive considerations against the compliance costs. Data from the 1982 Census of Retail Trade suggests that the industry is dominated in numbers by small firms but in sales by a few large firms; thus, using their data on size distribution of firms listing mail order as their primary industrial classification, a threshold of $5 million in gross sales would have exempted 96% of the firms whose primary classification was as mail order firms operating all year in 1982, but would still have covered 76% of the sales. A similar size distribution appears to hold for firms with mail order as a secondary industry; of the 1670 firms in this category, 1417 (85%) had fewer than 20 employees and would in most cases fall below a $5 million threshold.

7. "De-linking" Sales and Income Taxes. The long period during which Congress has linked the jurisdictional reach of state and local sales and use taxes to that of the state corporate income tax has been a handicap to bringing about any kind of change in either. This linkage, which antedates National Bellas Hess, has frustrated remedial action in the past; any legislation aimed at modifying the nexus standards of National Bellas Hess should not be dependent on the fate of efforts to impose Congressional restrictions on how states tax the incomes of multijurisdictional firms.

8. Timeliness. Several factors suggest that the time is appropriate for Congressional action. The issue of worldwide unitary corporate income taxation, to which the jurisdictional reach of the state sales and use tax has been linked in the past, shows signs of approaching resolution.

Recent reductions in federal grants to state and local governments, as well as continuing efforts to devolve responsibilities to states, place additional fiscal pressures on state and local financial resources. Congress could mitigate some of the fiscal impact of cutbacks and devolution by relaxing court-imposed restrictions on states' ability to raise sales and use tax revenues.

Commission Recommendation -- Sales and Use Tax
on Interstate Mail Order and Direct Marketing Sales

Alternative Recommendation #1. Affirm the Status Quo

The Commission believes that the serious difficulties posed by all of the proposed solutions to the out-of-state mail order problem outweigh the anticipated benefits to be gained from proposed remedial actions. Therefore, the Commission affirms the existing business presence requirements as set forth in numerous Supreme Court cases including National Bellas Hess, Miller Brothers, Scripto, and National Geographic and recommends that no legislative or judicial action be taken to alter those standards.

Pro: Mail-order spokesmen cite four arguments in favor of the status quo and against federal legislation that would require them to collect the use tax on their interstate sales if they do not meet the business presence test established by the Supreme Court in the cases cited. These arguments are:

(1) It would be unconstitutional; they argue that due process considerations prevent Congress from overturning the National Bellas Hess decision.

(2) It would be poor public policy because, unlike their in-state competitors, they receive no benefits from the taxing state in exchange for the use tax. This, they argue, is taxation without representation.

(3) It would constitute an undue burden to comply with the differing

use tax laws -- rates, exempt items, exempt buyers -- in 45 states and nearly 7000 local jurisdictions.

(4) The net effect of being forced to collect the use tax would be detrimental to their competitive position, driving many of the smaller firms out of business.

In addition to the arguments put forth by mail order firms, some students of federalism would see affirming the status quo as an appropriate expression of basic principles of federalism. All other proposed solutions involve federal intervention in order to help states collect a use tax which is inherently uncollectible from firms not meeting the existing nexus standard. If the firm has no assets in the state, then it is difficult if not impossible for a state to enforce a judgment or even to obtain the sales information on which to assess use tax collection liability without direct federal intervention. States should not enact a tax which is inherently uncollectible unless there is federal assistance.

Con: The constitutional argument is not clearly established. Many scholars feel that interstate commerce considerations, not due process, was the basis of National Bellas Hess, and read the majority decision as inviting Congress to exercise its commerce clause responsibilities and define the standards for use tax collection.

Tax authorities argue that because firms merely serve as collectors of the sales/use taxes, the purchasers are the real beneficiaries of the services financed by sales and use tax revenues.

While compliance costs for mail-order firms are indeed a serious concern, a number of proposed mechanisms have been offered to minimize

the burden, including a single state-local rate, wider use of collection cost allowances, and a de minimis rule that would exempt small firms from having to collect use tax.

The economic issues of competitive equity among sellers is a two-sided issue. It can be argued that the present situation provides a competitive disadvantage for in-state competing retailers because they cannot legally avoid the collection of the sales/use tax that averages 4.5% nationwide.

State officials feel that the central issue is the uniform enforcement of a clearly established use tax liability in order to promote tax fairness as well as to prevent further erosion of the sales and use tax base. Since property taxes are primarily local, and the federal government makes intensive use of the individual income tax, the sales and use tax is the only broad based tax which is primarily if not exclusively available for state government use. Thus, its perceived fairness and the integrity of its sales base should be safeguarded.

Alternative Recommendation #2. State-initiated Litigation to Reduce Use Tax Evasion

The Commission recognizes that significant changes have occurred in the composition and technology of the retail sales market in the 18 years since National Bellas Hess. It is also keenly aware of the need to equalize the competitive position of in-state and out-of-state vendors and to safeguard state sales and use tax bases and revenues while minimizing the intrusion of Congress into state affairs. To achieve these ends, the Commission recommends that states actively pursue litigation intended to modify or overturn the nexus standards established in National Bellas Hess. If successful, states should then implement collection of use taxes on interstate mail order sales through multistate cooperative agreements.

Pro: This approach involves minimum federal intervention in state and local taxation. It merely seeks a return to the status quo ante by redefining nexus (business presence or linkage) in a way that would permit states to pursue the collection process with mail order firms on their own. That is, the Court would simply be turning the clock back to the enforcement situation prior to National Bellas Hess. Congress need not intervene.

If successful, litigation could meet some of the major concerns of both state revenue officers and competing firms who are currently disadvantaged by having to collect the tax.

By keeping the issue out of Congress, states will not have to face a high risk situation -- a quid pro quo deal narrowing the scope of the

state corporate income tax. The price of Congressional help on the sales and use tax front would be curtailment of state corporate income tax powers. For at least two decades, business interests have urged Congress to take a wide variety of actions that have as a central objective the limitation of state authority over multistate firms in the corporate income tax area. It can therefore be predicted with absolute certainty that any effort on the part of state governments to seek Congressional help with interstate sales and use tax problems will again be confronted with a demand on the part of business interests for offsetting action on state corporate income tax. A recent G.A.O. report calling on Congress to mandate uniform apportionment for state corporate income taxes is indicative of continued pressure in this area.

The current problem of a large group of firms and a large volume of sales not subject to either sales or use tax arises from a Court decision; it seems appropriate to attempt to resolve the issue by the same means. In particular, if due process considerations are important, then the Court is a more appropriate forum than Congress.

Con: State revenue officers are not sanguine about the cost or prospects of success of litigation to modify or overturn **National Bellas Hess**. They view this approach as likely to provide some expansion of coverage but not likely to create an "equal playing field" among all firms regularly selling in a particular state market.

Multiple cases may be required to determine the legal status of all the varieties of nexus which could arise from various methods of soliciting sales. For example, **National Bellas Hess** ruled only on the standard of catalog mailings; **Miller Brothers** ruled only on the issue of

sporadic own truck deliveries with no advertising; Scripto, Inc. dealt only with independent jobbers. Each of numerous varieties of nexus could easily be an additional case.

Because issues of compliance costs for small firms and the treatment of local sales taxes will not be resolved through litigation on nexus standards, business firms who would become liable for collection may be adversely affected by approaching the issue through litigation rather than legislation. States cannot be expected to address compliance cost issues or to establish a single state-local rate unless compelled to do so.

The concern about federal intervention in the corporate income tax area as a quid pro quo may be overstated as a practical matter. The sales and use tax is a much more significant revenue source for most states than the corporate income tax, and the prospective tax revenue losses from proposed changes in the latter are far outweighed by the potential revenue gains from being able to collect use tax on all interstate mail order sales.

Enforcement through reciprocal agreements is not a simple matter in the absence of federal legislation. While states honor court judgments, many are hampered in enforcing reciprocity in the case of administrative judgments by the determination of their own courts.

Alternative Recommendation #3. Corrective Federal Legislation to Enable States to Enforce Use Tax Collection

The Commission recognizes that significant changes have occurred in the composition and technology of the retail sales market in the 18 years since National Bellas Hess. It is also keenly aware of the need to equalize the competitive position of in-state and out-of-state vendors and to safeguard state sales and use tax bases and revenues. To achieve these aims, the Commission recommends that Congress enact legislation that would negate the National Bellas Hess decision by requiring mail order vendors to collect a state's use tax on interstate sales delivered in that state, if the mail order vendor engages in regular or systematic solicitation of sales in that state through catalogs, advertising, or other means. To relieve the compliance cost burden on small businesses, the legislation should contain a de minimis rule, exempting vendors with national sales and/or sales in the destination state below a specified threshold dollar amount. The de minimis figure(s) should be determined by Congress, but should be no less than [$5 million] [$12.5 million] in gross sales.

To minimize compliance costs for firms operating in multiple jurisdictions, states in which there are local sales and use taxes should determine a non-discriminatory single rate, either (a) the state rate only or (b) a combined state and local rate that the out-of-state seller may elect to charge in lieu of applying the

combined state and local rates for all jurisdictions which are the destinations of the sales.

To protect firms from indeterminate tax liabilities for past sales, no state should be allowed to collect any additional taxes based solely on retroactive application of any Congressionally authorized modification of nexus standards.

Pro: This alternative of corrective federal legislation offers the most direct and comprehensive resolution of the competitive fairness, tax revenue, and compliance cost issues. Nexus standards (the degree of business presence needed to require collection of use tax) would be defined clearly in all situations at the same time. The existing confusion might well be perpetuated by further courts decisions as it has been in the past; legislation could resolve this confusion in definitive fashion.

In sharp contrast to judicial decisions, Congressional action could weigh a broader business presence standard against the legitimate business concerns about compliance costs and protection for small firms. Business interests in a de minimis rule, uniform state-local rates, and amnesty for prior taxes could be addressed in legislation. All of the economic issues -- tax revenues, competitive fairness, and compliance costs could be resolved through appropriate legislation. These concerns would not be addressed in a judicial context.

Congress was invited by the Court to act under its interstate commerce responsibilities in the majority opinion in National Bellas Hess. This suggests that the Court is unwilling to continue to define nexus standards in a series of cases.

Legislation could also address the problem of enforcement. Congressional authorization for either reciprocal agreements (bilateral or multistate) or the use of federal courts could cut through the thicket of difficulties surrounding enforcement of a use tax across state lines. Litigation would not resolve the problem of enforcement. States usually cannot obtain the transaction information from out-of-state vendors needed to collect the use tax directly from the customer. This problem of access to information would probably remain the single most important barrier to effective tax collection even if litigation were successful.

Congressional action at this time would be a particularly appropriate instance of intergovernmental comity in the light of recent cuts in federal grants to states and localities, the prospect of further grant reductions, the potential impact of federal tax reform proposals, and proposals for devolution of responsibilities.

If states and local governments had been able to collect sales and use taxes on out-of-state mail order sales in 1985, they could have collected more than an additional $1 billion in revenue. If mail order sales continue to grow, the potential revenue will also increase. This additional revenue would be particularly helpful to states and localities at this time.

Con: The alternative of corrective federal legislation would involve action by Congress to reverse a long-standing decision of the Supreme Court. There is legal disagreement on whether it is possible for Congress to overrule the decision in National Bellas Hess. Although that decision was based primarily on interstate commerce arguments, it is not devoid of due process language.

Federal legislation on nexus standards is a more intrusive solution than the litigation approach set forth as Alternative #2. If Congress acts, it would be likely to modify state sales and use tax statutes in some respects, particularly in the area of collection/compliance costs and the collection of local use taxes. A de minimis rule, a combined state/local uniform rate, non-collection of local taxes, or a collection cost allowance would all alter the current sales and use tax practices of most states.

Broadening the issue by opening it to legislation is not an unmixed blessing. Hearings are likely to restore the linkage between state corporate income taxes and sales and use taxes, which can be broken in a litigation approach. While the gains in tax revenues on sales and use tax on interstate mail order sales would undoubtedly far exceed the losses from accompanying changes in state corporate income taxes, the legislative process is not costless to state revenue officials. To put the issue more bluntly, the price that states may have to pay for Congressional help in extending their sales/use tax reach is potential cutback in state jurisdictional reach in the corporate income tax area.

<u>De minimis rule:</u>

There seems to be broad acceptance of the notion that small firms should be protected from the very high costs of multistate compliance. Empirical studies of compliance costs consistently indicate that they are highest for smaller firms. Even from the revenue collection standpoint, it would be cost effective to exempt small firms and thereby reduce the state's high collection costs in collecting small sums through a large

number of small vendors. While there are a large number of firms in the mail order segment of retail sales, there are many small firms and a small number of large firms who generate most of the sales volume. Thus, tax revenue could be collected on a large proportion of mail order sales while tax collectors only have to deal with a relatively small number of additional registered sellers.

The determination of the most appropriate level of the de minimis exemption could be based on any one of several criteria. One possible criterion is based on compliance costs. A firm which markets computer software for sales and use tax calculations estimates that annual sales of $5 million would be necessary before use of this software would be cost effective; on this basis, firms with sales volume of less than $5 million would be exempt. Alternatively, the exemption could be based on Small Business Administration size standards. The SBA sets specific standards for various industries; for mail order firms, the SBA 1984 threshold sales volume was set at $12.5 million.

Some objections have been raised to a de minimis exemption because small in-state firms enjoy no exemption. Also, in many sales and use states, a collection cost allowance covers some part of the collection cost.

A useful supplement or alternative to the de minimis rule would be to require all states to provide a collection cost allowance on interstate sales.

Single rate in each state:

This provision would reduce the number of rates facing a multistate firm to a maximum of 46. Since the process of determining a combined state-local rate is difficult in those states where local rates are non-uniform and/or the use of local sales taxes is limited to certain jurisdictions, it might be preferable to limit use tax collection to simply the state tax. There is a strong precedent for excluding local use taxes from federal legislation because they are not presently enforced on purchases within states, i.e., a purchase made in City A in Ohio with no local sales tax would not be assessed for a local use tax in the purchaser's home City B when he brings the item home. On the other hand, potential tax revenue -- substantial amounts in some states -- is lost by excluding local taxes. New York City, for example, has a local rate which is higher than the state rate, and is a major population center.

Amnesty:

This provision protects firms from indeterminate liabilities for back taxes. It would be particularly important for small firms wishing to sell the firm or issue stock or debt, since it would free them from the spectre of an indeterminate contingent liability for use taxes.

NOTE TO READER A legislative fact sheet is provided at the end of this chapter.

Alternative #4. A Direct Federal Tax on Interstate Mail Order Sales

The Commission recognizes that significant changes have occurred in the composition and technology of the retail sales market in the 18 years since National Bellas Hess. It is also keenly aware of the need to equalize the competitive position of in-state and out-of-state vendors and to safeguard state sales and use tax bases and revenues. On the other hand, the Commission is concerned that any corrective action pay adequate attention to the problem of the cost of business compliance. The Commission therefore recommends that Congress enact legislation providing for a federal mail order sales tax at a single rate on all sales outside the state(s) where the mail order firm is located. This rate would be set by Congress at approximately the national average of current state sales tax rates. Revenues collected would be distributed among the states according to some proxy for mail order purchases, such as population, personal income or state retail sales.

Pro: The attraction of this alternative lies in its relative simplicity. Congressional action to negate a Supreme Court decision would not be required. This approach would minimize compliance costs for firms by providing a single rate for all out-of-state mail order sales. Thus, compliance costs would be no different than for an in-state firm.

Competitive concerns would be addressed to a large degree in that all sales would be subject to either state or federal tax.

Revenue concerns would also be addressed since the revenue would be shared with the states, or at least with the sales and use tax states. Thus, all three economic concerns would be addressed directly.

Con: A national tax on interstate mail order sales would represent the greatest degree of federal intrusion of the three alternatives considered, since the federal government would be adopting a portion of a state tax and distributing revenues to states. State officials would be concerned about a federal "invasion" of a traditional state and local revenue source, even if initially it were limited in scope and committed to distribution to the states.

There is no completely satisfactory criterion for distributing federal tax revenues to the states of destination, because none of the obvious criteria -- population, retail sales, or sales tax collections -- are necessarily closely related to mail order purchases.

The single national rate would be too high for some states and too low for others for competitive and revenue purposes. There would be no satisfactory way of reflecting the exemptions of the various states.

Sales and use taxes would be imposed on a part of the purchases by residents of the five states not presently using such taxes.

Notes to Chapter I.

[1]National Bellas Hess v. Illinois Department of Revenue, 386 U.S. 753.

[2]In ten states and the District of Columbia a newly purchased motor vehicle is subject to a special levy in lieu of a sales or use tax. This levy is sometimes at the same rate, higher in one state and lower in a few others.

[3]Due, John F. and John L. Mikesell, "State Sales Tax Structure and Operation in the Last Decade -- A Sample Study", National Tax Journal, Vol. XXXIII, March 1980, No. 1, p.42.

[4]1982 Census of Retail Trade, Department of Commerce, Bureau of the Census. This Census is done at 5-year intervals.

[5]Advertising Age, January 17, 1983, reports 1981 direct marketing sales estimated by the Direct Marketing Association of $125 billion, including $45 billion in mail order catalog sales. At a 9% average growth rate from 1972 to 1982 (Census of Retail Trade), projected 1985 sales would exceed $200 billion. However, this includes a large volume of sales that is already taxed (direct marketing in households, e.g. Avon, Mary Kay, Tupperware, or firms with in-state business presence) or not be taxable in any case (sales of industrial consumables, charitable sales). Marketing News, December 9, 1983, reported 1982 mail order sales of $90.3 billion, based on the 1982 edition of The Guide to U.S. Mail Order Sales, of which $41.4 billion was to consumers, with a growth rate of 8%-12%.

[6]Fishman, Arnold, The Guide To U.S. Mail Order Sales 1983, Deerfield, IL, 1984, Marketing Logistics Inc.

[7]There is some evidence that tax avoidance is a motive for mail order and border state purchases; see, for example, "You Can't Hide in Your Mailbox", Forbes, July 16, 1984, p.86-87; and "Evading of Sales Tax by New York Stores Under Investigation", New York Times, July 30, 1984, p.A1/A.17.

[8]Detailed state-by-state estimates are presented in Chapter III.

[9]Calculated from Significant Features of Fiscal Federalism, Advisory Commission on Intergovernmental Relations, various issues.

[10]Reported in private conversation by a representative of Vertex, Inc., a Philadelphia software firm.

[11]1982 Census of Retail Trade: Establishment and Firm Size, U.S. Department of Commerce, Bureau of the Census, February 1985: Government Printing Office, Washington, D.C.

[12]Advisory Commission on Intergovernmental Relations, Local Revenue Diversification: Income, Sales Taxes and User Charges, A-47, Washington DC, 1974.

[13]ACIR Docket Book, 73rd Meeting, April 22-23, 1981, Washington, D.C., Tab B, p.16.

LEGISLATIVE FACT SHEET
FOR POTENTIAL LEGISLATION
ON TAXATION OF INTERSTATE MAIL ORDER SALES

Purpose: Under its authority to regulate interstate commerce, Congress would grant to the states the authority to require an out-of-state mail order firm to collect the state's use tax on sales made to residents of the state if the firm met certain "nexus" requirements -- conditions that would constitute sufficient business presence in the state.

Nexus requirement: A mail-order firm would, under this legislation, be considered to have "sufficient nexus" if two conditions are met:

1) the destination of the sale is in that state and

2) the seller engages in regular or systematic solicitation of sales in that state in order to compete for sales in the consumer market of the destination state.

Treatment of local taxes: In order to simplify compliance for multistate sellers, mail-order firms which meet the nexus requirements for use tax as defined in this bill, but do not meet the nexus requirement for sales tax, shall

Alternative One: have the option of collecting a single combined state-local rate in each state, the rate to be determined by the state, in lieu of the actual combined state-local rate in the destination locality.

Alternative Two: collect only the state use tax and not any local sales or use taxes.

De minimis rule: A state may require an out-of-state mail order person or firm to collect use taxes under this bill only if that person's or firm's annual gross sales;

Alternative One: exceed $xxxx on a national basis in that calendar year.

Alternative Two: exceed $xxxx in the destination state in that calendar year.

Amnesty. No person or firm who becomes liable for collection of use tax as a result of this bill that was not previously so obligated may be subject to retroactive application of the bill's provisions.

Mr. NETHING. ACIR adopted a policy calling for Federal legislation to overturn *National Bellas Hess*. The written dissent from some of our members will be filed with the committee as it is finalized.

Let me address the concerns which NCSL established in its policy statement on correcting *National Bellas Hess*. I have attached a copy of our policy statement to my testimony.

The court questioned the ability of a State to reach outside of its borders. It based the reach of a State on the doctrine of nexus, and then effectively defined "nexus" as a physical presence in the State without clearly establishing minimum or maximum tests.

The court, in 1967, had no way to foresee the tremendous potential growth of the mail order business. In 1967, $12.9 billion was the annual sales volume attributable to direct mail order. By 1981, that had grown to over $50 billion.

ACIR discovered a range of estimates from $59 billion to $100 billion in 1983. More important is the percentage share of the market which this represents, about 10 to 12 percent per year and growing.

While a significant percentage of these sales are attributable to such companies as Sears Roebuck, Montgomery Ward, and J.C. Penny, each of which has a physical presence in probably every State and thus collect the taxes, the portion of untaxed sales is growing. We don't know how fast, but I do know the number of catalogs my wife receives on a regular basis.

The results for our State policy makers is an increasing bias against in-State retailers favoring out-of-State mail order houses. Without a reversal of *Bellas Hess,* a State's tax policy cannot correct this bias while retaining a sales or a use tax.

There has been discussion that State compacts could be established to facilitate the collection of these taxes and that Federal legislation should address this approach instead of the question of State authority. However, the *Bellas Hess* decision restricted the authority of States and requires this authority question to be addressed.

State legislators feel that advertising and soliciting sales in States is sufficient grounds for being required to conform to the laws of that State. There is no need for such compacts to collect this tax if the principle of the liability for the tax is restored. Once established, the businesses should be able to deal with the States.

We believe the same computerization which allows these companies to reach such a wide audience with personalized mailing addresses, or to bill directly over the telephone, is guaranteed that it would require only minimal cost to identify the States of each sale and to create the necessary accounting of the sales tax collected.

The fact that there is sufficient education to read the advertising, there are sufficient jobs to provide income, and there are roads to aid and delivery, all argue that the out-of-State vendor does benefit from the State tax. This side of the issue of fairness must be settled once and for all. Examined today, the issues of nexus and due process should both be decided in favor of the States.

NCSL asks that legislation be enacted to authorize States to require the collection of sales and use taxes by interstate sellers who solicit business in a taxing State through catalogs advertising materials, radio, television, electronic media, telecommunications, and

the press. It is our belief that such legislation should be prospective and provide for the ability of States to establish by law a single statewide sales tax rate for their State for use by out-of-State retailers.

NCSL agrees with the difficulty of a business trying to accurately identify in which of over a thousand taxing jurisdictions a sale was made. However, by being allowed to establish a statewide rate for out-of-State retailers, perhaps even at the cost of the authority to tax the purchases, States could reduce the inequity inherent in the current situation.

Senator CHAFEE. Why don't you go ahead and finish up, Senator?

Mr. NETHING. All right. Thank you. Just another 30 seconds.

The State legislators who developed this policy debated the issue of a de minimis rule at length, realizing the need for some protection for very small businesses. No decision was made on such a provision with the expectation that Congress in its review would be better able to judge the makeup of the industry and determine the extent of protections needed. Many State statutes already provide such de minimis protections.

The bill before you today, S. 1510, introduced by Senator Andrews, is a strong beginning toward the enactment of this needed Federal legislation. Interstate commerce is the Federal interest in this issue which the Supreme Court cited in the decision on *National Bellas Hess*. Senator Andrews is to be commended both for his taking responsibility for interstate commerce which rightfully belongs at the Federal level and for responding to the concerns of the States and our taxpayers.

There are appropriate roles for the States and for the Federal Government. The NCSL calls on the Congress and the Federal Government to restore to the States the ability to require the collection of this tax in order to restore fairness to State sales and use taxes and to end the continuing loss of State revenues due to the *Bellas Hess* restriction.

Thank you for letting us testify today.

Senator CHAFEE. Well thank you very much, Senator Nething. Before we go further, I know that you are from North Dakota, and we have a subsequent witness from North Dakota. So perhaps at this point, Senator Andrews would like to formally introduce you and say a little bit about you and the subsequent witness, Mr. Wheeler. Senator.

Senator ANDREWS. Well, Dave Nething, Senator, is the majority leader of our North Dakota State Senate. He is a long-time friend. He is an attorney from Jamestown, ND, well respected in his community and across the State of North Dakota.

And following him will be Art Wheeler, who is the president of the North Dakota Retail Association in Bismarck, ND, doing an outstanding job for our local retailers. Dave is stressing, of course, the revenue loss to the States. And not only with his North Dakota hat on, but also in his position as the head of the National Conference of State Legislators. He is speaking for legislators across this Nation.

Art Wheeler is speaking not just for one or two individual retailers but for all of the retailers in a small State, and I think speaks

typically for retailers in whatever State they might be situated. And we appreciate your hearing them.

Senator CHAFEE. Well thank you, Senator Andrews.

Senator Nething, in anticipation of the testimony we will receive from Mr. Glazer or others—and we will be hearing from other witnesses in the subsequent hearing—I would like you to comment on the mechanical problems for the direct vendor. They will probably also raise the point that they do not get any advantage from the State. I think that both you and Senator Andrews have addressed that. When it comes to fairness, I think the issue is clear, at least as far as I am concerned.

However, the mechanical side of this issue is of concern. Now what do we do? Is it possible to have equity? Let's say in North Dakota there is a 4-percent sales tax, and in Jamestown, or the county you are in, there is another 1 percent. What are you going to do? Are you going to impose a 5-percent sales tax on all goods coming into North Dakota? Or 4 percent? You are still going to have a little bit of inequity if you do either way. Are you going to leave it up to the direct marketer for some way to figure this thing out? What is a child's clothing? Where do you draw the line in the size of the shirt and so forth?

How would you handle that?

Mr. NETHING. Mr. Chairman, you have asked a series of questions there and perhaps I could respond this way. First of all, in our NCSL policy, we are suggesting that the States would set a single rate so that these companies would only have to deal with the State rates. They would not have to deal with the individual jurisdiction rates as we know exist throughout the country.

Second, as I mentioned, I was a member of the Advisory Commission on Intergovernmental Relations and several of these questions came up. And I think that is the reason that we suggested a de minimis rule, so that we would be able to take care of some of those smaller businesses that—primarily in the interest of trying to make it work.

I think in Senator Andrews 'testimony he indicated that we don't have in our State a de minimis rule. What we do is we have different rules for submitting the money to the State. So there are some variations that take place.

On the matter of separating what would be taxable and what is not taxable, let me suggest that Sears, Roebuck & Co. has been doing this for a long time. J.C. Penny Co. has been doing it for a long time. Montgomery Ward & Co. has been doing it for a long time. In North Dakota, for example, we have many, many items that are not applied—the tax does not apply to. And the computer industry has resolved these questions as they put these cash registers together, these types of things. So I think it can be dealt with. I think it is a question of having to have the authority so that people then may plan accordingly.

At the present time, of course, since they are exempt, no one has done anything in the area. But I think there are enough examples that we could learn from.

Senator CHAFEE. All right.

Senator Andrews, any questions of you?

Senator ANDREWS. I have no questions. I just want to thank him.

Senator CHAFEE. Well thank you very much, Senator Nething. We might be getting back to you as we go through the panel.

Mr. NETHING. Thank you.

Senator CHAFEE. Mr. James Martin, legislative counsel, National Governors Association.

[The prepared written testimony of Mr. Nething follows:]

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Testimony of

Honorable David Nething

Majority Leader, North Dakota Senate

President-elect

National Conference of State Legislatures

on behalf of the

National Conference of State Legislatures

before the

United States Senate

Committee on Finance

Subcommittee on Taxation and Debt Management

November 15, 1985

Mr. Chairman, Members of the Committee, thank you for this opportunity to address you today on an issue of concern to state legislators across the country. My name is David Nething and I serve as the Majority Leader of the North Dakota Senate. I also serve for fifteen more days as the President-elect of the National Conference of State Legislatures, at which time I become President.

In 1983 NCSL again revisited the issue of the U.S. Supreme Court's 1967 National Bellas Hess decision. At the same time the Advisory Commission on Intergovernmental Relations was studying the matter. Senator David Durenberger, Senator William Roth and Senator James Sasser are members of ACIR representing the U.S. Senate. I am one of the state legislative representatives and have been since August, 1982. Before presenting NCSL's concerns, I'd like to present you with copies of the ACIR policy position adopted earlier this year along with some background information, and I ask that you make it a part of your record for this hearing. The ACIR adopted a policy calling for federal legislation to overturn National Bellas Hess.

Let me address the concerns which NCSL established in its policy statement on correcting the National Bellas Hess decision. I have attached a copy of the statement to my testimony. The Supreme Court decision ended the ability of states to require out-of-state mail order houses to collect sales or use taxes on sales made into the state. The court questioned the ability of a state to reach outside its borders. It based the reach of the

state on the doctrine of nexus and then effectively defined nexus as a physical presence in the state, without clearly establishing minimum or maximum tests.

The court in 1967 had no way to foresee the tremendous potential growth of the mail order business. In 1967, $12.9 billion was the annual sales volume attributable to direct mail orders. By 1981 it had grown to over $50 billion. The ACIR discovered a range of estimates from $59 billion to over $100 billion in 1983. More important is the percentage share of the market which this represents, about 10-12% per year and growing.

While a significant percentage of these sales are attributable to companies such as Sears Roebuck, Montgomery Ward and J.C. Penney, each of which have a physical presence in probably every state and thus collect the taxes, the portion of untaxed sales is growing. We don't know how fast, but I do know the number of catalogs my wife receives on a regular basis.

The result for state policy makers is an increasing bias against in-state retailers favoring out-of-state mail order houses. Without a reversal of Bellas Hess, state tax policy cannot correct this bias while retaining a sales or use tax. The only other alternative is attempting to collect the use tax from the purchaser which would be an inefficient use of state resources. Thus the Supreme Court's decision must be reversed to regain the level playing field that economists always talk about and that state legislators call fairness in tax policy.

There has been discussion that state compacts could be established to facilitate the collection of these taxes and that federal legislation should address this approach instead of the question of state authority. However, the National Bellas Hess decision restricted the authority of states and requires this "authority" question be addressed. State legislators felt that advertising and soliciting sales in states is sufficient grounds for being required to conform to the laws of that state. There is no need for such compacts to collect this tax if the principle of the liability for the tax is restored. Once established, businesses should be able to deal with the states. We believe the same computerization which allows these companies to reach such a wide audience with personalized mailing addresses or to bill directly over the phone guarantee that it would only require minimal costs to identify the state of each sale and to create the necessary accounting of the sales taxes collected.

The fact that there is sufficient education to read the advertising, that there are sufficient jobs to provide income, that there are roads to aid in delivery, all argue that the out-of-state vendor does benefit from the state tax. This side of the issue of fairness must be settled once and for all. Examined today, the issues of nexus and due process should both be decided in favor of the states.

Second, because of the large and ever increasing volume of mail order and direct sales, states collectively are facing a revenue loss estimated to be over $1 billion annually. The ACIR compared a range of estimates and

decided that between $667 million and $1.65 billion of state revenue was being lost annually. At a time when the federal government has asked states to take over a wide range of service programs which it can no longer afford to fund, when it is considering ending the deductibility of state and local taxes and restricting all tax-exempt financing--even certain general obligation bonds, this inappropriate and unfair barrier to state revenues should be removed.

It is also apparent that the federal government is engaging in ever greater tax competition with the states, including pending legislation establishing a national excise tax on manufacturing, and legislation making permanent the doubling of the tobacco tax which completes the doubling of the big three excise taxes in the last four years: alcohol, tobacco and motor fuels. Further, the congressional debate on the Gramm-Rudman deficit reduction package clearly signals future reductions in grants-in-aid to states. All of this points to the need for states to have access to adequate revenue systems, and the Bellas Hess decision today interferes with effective and fair state sales and use taxes.

A third major concern facing the states is the tremendous increase in the use of sophisticated telecommunications and computer-based sales opportunities that are becoming more readily available to a wider audience. The growth in mail-order sales may soon increase even more dramatically and the retail sales tax base--one of the two major state revenue sources--will soon be even more crippled. Thus the need to correct this restriction grows greater each year.

NCSL asks that legislation be enacted to authorize states to require the collection of sales and use taxes by interstate sellers who solicit business in a taxing state through catalogs, advertising materials, radio, television, electronic media, telecommunications and the press. It is our belief that such legislation should be prospective and provide for the ability of states to establish by law a single statewide sales tax rate for their state for use by out-of-state retailers.

NCSL agrees with the difficulty of a business trying to accurately identify in which of over a thousand taxing jurisdictions a sale was made. However, by being allowed to establish a statewide rate for out-of-state retailers, perhaps even at the cost of the authority to tax the purchases, states could reduce the inequity inherent in the current situation.

The state legislators who developed this policy debated the issue of a de minimis rule at length, realizing the need for some protection for very small businesses. No decision was made on such a provision with the expectation that Congress in its review would be better able to judge the make-up of the industry and determine the extent of protections needed. Many state statutes already provide such de minimis protections.

The bill before you today, S. 1510, introduced by Senator Mark Andrews, is a strong beginning toward the enactment of this needed federal legislation. Interstate commerce is the federal interest in this issue which the Supreme Court cited in the decision on National Bellas Hess.

Senator Andrews is to be commended both for his taking responsibility for interstate commerce which rightfully belongs at the federal level, and for responding to the concerns of the states and our taxpayers.

There are appropriate roles for the states and for the federal government. The NCSL calls on the Congress and the federal government to restore to the states the ability to require the collection of this tax in order to restore fairness to state sales and use taxes and to end the continuing loss of state revenues due to the Bellas Hess restriction.

Again, I thank you for this opportunity to testify and I'd be glad to answer any questions you might have.

National Conference of State Legislatures

Office of State Federal Relations

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Executive Director
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Correcting the National Bellas Hess Decision

Adopted May 10, 1985

The National Conference of State Legislatures is aware that states have been seriously handicapped in their ability to collect legally-due sales and use taxes on interstate sales because of the 1967 U.S. Supreme Court decision in the National Bellas Hess case.

The National Bellas Hess decision denies states the legal authority to require the collection of sales and use taxes by out-of-state mail order firms that have no physical presence in the taxing state but that may advertise extensively there through the mails or common carriers.

The National Bellas Hess decision has resulted in a loss of hundreds of millions of dollars in sales and use tax revenue to the states and has placed local business and out-of-state retailers with physical presence in taxing states at a serious competitive disadvantage.

State revenue losses and the competitive disadvantage of local business have been intensified in recent years because of the great growth in untaxed mail-order sales or similar out-of-state sales and these problems can be resolved only by the correction of the National Bellas Hess decision. Today, many projections show that the rapidly accelerating pace of growth in mail order, phone and computer-generated sales could reach a major share of all sales by the next decade, rendering state sales and use taxes ineffective.

The National Conference of State Legislatures calls on the Administration and the Congress to introduce, consider and enact legislation that would prevent this huge state revenue loss and remove the competitive advantage now enjoyed by out-of-state business, and that they do so by authorizing the states to require the collection of sales and use taxes by interstate sellers who solicit business in a taxing state through catalogs, advertising materials, radio, television, electronic media, telecommunications, and the press. In developing this legislation, NCSL asks that all changes be prospective and provide for the ability of states to establish by law single statewide sales tax rates for use by out-of-state retailers.

STATEMENT OF JAMES L. MARTIN, LEGISLATIVE COUNSEL, NATIONAL GOVERNORS' ASSOCIATION, WASHINGTON, DC, ACCOMPANIED BY KARON BENKER, ASSOCIATE DIRECTOR, NATIONAL ASSOCIATION OF STATE BUDGET OFFICERS

Mr. MARTIN. Mr. Chairman, Senator Andrews, I will be glad to wait my time for Senator Andrews' time if you would like Mr. Wheeler to go next.

Senator CHAFEE. Oh, no. That's fine.

Senator ANDREWS. That's fine.

Mr. MARTIN. I want to thank you for the opportunity to present our comments and views on this very important issue, and I especially thank Senator Andrews for encouraging the hearings and in getting the issue discussed before the Senate.

I have with me today, Mr. Chairman, Miss Karon Benker, who is associate director of the National Association of State Budget Officers if we need to ask some other questions later.

The National Governors Association and the National Association of State Budget Officers strongly support Federal legislation that would correct the 1967 Supreme Court decision National *Bellas Hess* vs. *Illinois Department of Revenue.* It would restore the State enforcement power over out-of-State mail order sales.

We are asking Congress to simply return to the States the taxing powers that existed before Federal intervention. The change that we are asking for today is a modest request to strengthen state taxing authority.

Here are just three simple reasons why Congress should correct *National Bellas Hess*:

The first is to support State enforcement efforts; the second is to close a tax loophole; and the third is to be fair to in-State retailers. First, to support State enforcement efforts. States already have the power to tax goods purchased outside the State, but are denied enforcement mechanism to collect the taxes that are due. The judicial interpretation of *Bellas Hess* created an avenue for tax evasion. The customer is still liable for the sales tax on retail goods purchased out-of-State; however, it is virtually impossible for State tax revenue departments to find the customers and assess the tax. In fact, most customers are not even aware that taxes are owed. State have always relied on the help of firms to collect taxes, whether they be sales taxes, personal income taxes, unemployment compensation taxes, or excise taxes on cigarettes and alcoholic beverages.

It has been noted that many retail firms are complying with paying State sales taxes at the current time with little or no difficulty.

Today, we are asking Congress to give States the power to enlist the help of a few other out-of-State firms to act as an agent of the State in collecting State taxes due. Overturning *Bellas Hess* has simply returned a valuable tax collection tool to the State.

It is important to remember that most State sales taxes are levied on the customer, not the retail firm. These sales taxes are then used to purchase public services for those taxpayers.

And, also, to close the State tax loophole. State sales taxes now comprise 32 percent of all State tax collections, and local sales

taxes are fast becoming an important revenue source for cities, counties, and mass——

Senator CHAFEE. Mr. Martin, what would be most helpful—since we have your statement and we do not have too much time—would be for you to address the tax administration issues.

Mr. MARTIN. Yes, sir. I will move to that section.

The Governors and their budget officers recognize that interstate cooperation is necessary to insure smooth tax administration if *Bellas Hess* is overturned, and, consequently, we are prepared to look at all of the administrative issues and to work with the committee, and to create a task force to work with the committee on all of the specific administrative issues that were to be acceptable to the committee and the majority of the Senators.

And several specific issues: Uniformity of collection efforts. Sales taxes are levied in 46 States and each one has its own rules and regulations regarding how the tax is to be collected. The Governors would support any reasonable proposal to impose uniform reporting and remittance regulations. The Governors would be happy to participate in the designing of such regulations. The State tax administrators have been working and have many suggestions on how to do this.

In terms of the de minimis rule, the Governors also understand that sales tax collection efforts could be burdensome to small firms, as you have already mentioned, Mr. Chairman. Therefore, we support the recommendation of the Advisory Commission on Intergovernmental Relations: the committee may choose a different de minimis rule.

Senator CHAFEE. Do the Governors have a representative on the Advisory Commission?

Mr. MARTIN. Yes. There are four Governors on the Advisory Commission on Intergovernmental Relations.

The ACIR recommendation is for a de minimis rule of $12.5 million in annual sales. It is our understanding that this de minimis rule would cover less than 200 companies in the country and exempt 6,000 mail order firms that might be covered by the legislation. It eliminates the small mail order firm with a large de minimis rule.

Senator CHAFEE. Six thousand would be eliminated?

Mr. MARTIN. Six thousand eliminated.

The ACIR estimate of the $12.5 million annual sales, in the de minimis annual sales, but it would cover less than 200 firms.

Senator CHAFEE. I see.

Mr. MARTIN. But it would pick up more than 70 percent of the revenues lost. And the committee, I am sure, would look into other de minimis rules.

ACIR's original recommendation was for a $5 million de minimis rule, and the committee may have others.

Senator CHAFEE. You mean its original recommendation?

Mr. MARTIN. Well in the first staff draft.

Senator CHAFEE. I see.

Mr. MARTIN. The members chose the $12.5 million annual sales.

Senator CHAFEE. All right.

Mr. MARTIN. And the other administrative issue that we have addressed here is the fact that you have said of the different State

tax systems, plus the fact that we have a lot of local government sales taxes. There are thousands of local governments with sales taxes.

We think that there could be a single State tax rate that that could be worked out easily in technical discussions with the committee staff, and if presented to the committee, the committee could decide a single State rate.

Senator CHAFEE. Then I think also you should have a single time for making your returns. In other words, in some States the merchant must file a return of his sales taxes in a very short time; others are more lenient.

Mr. MARTIN. Our current discussions would be amenable to a quarterly procedure.

Senator CHAFEE. Quarterly?

Mr. MARTIN. Quarterly.

Senator CHAFEE. Well they get the use of the money anyway. All right.

Mr. MARTIN. We really don't think those problems are insurmountable.

Senator CHAFEE. Good.

Mr. MARTIN. In fact, reference has been made to the fact that we think they all can be addressed and fairly easily.

Senator CHAFEE. Senator Andrews, do you have any questions at this time?

Senator ANDREWS. Yes, one question, Mr. Martin. Based on your experience with the National Governors Association—and we have been addressing the mechanical problems of this legislation—you are aware of the fact, of course, that mail order companies now do collect sales taxes on sales in the State where there is a physical presence, such as in Maine. L.L. Bean collects sales tax in Maine on those goods it ships in Maine. There isn't any problem with that. They seem to be able to do that all right with the State taxing authorities, don't they?

Mr. MARTIN. Yes, sir. And in fact we think that the new, if you were to reverse *Bellas Hess,* it was nothing more than a handling charge. Businesses are used to adding to mail order sales a handling charge. We know it ourselves as we do mail order sales, they add a little handling charge. We think it is in that category of complexity and it can be handled as a handling charge.

Senator ANDREWS. So in your experience in the several States where this type of sales tax collection is being made by mail order firms, you know of no problems in the mechanics of doing it?

Mr. MARTIN. Not in the mechanics, beyond the fact that none of us like taxes.

Senator ANDREWS. Well that's true. But it is not a tax on the mail order sales. All they are doing is being a collection agency. The customer pays the tax when it equalizes their price.

Mr. MARTIN. The tax is on the customer.

Senator ANDREWS. Thank you, Mr. Martin.

Mr. MARTIN. And we have some States, Mr. Chairman, I think it is Pennsylvania that pays a 1-percent collection fee. Illinois, maybe a 2-percent fee. And if there is a problem there in terms of administrative cost, we are willing to discuss this.

Senator CHAFEE. I can see some mechanical problems beyond the ascertainment of who or what jurisdiction has to pay the tax. I can see the problems in the forms. If L.L. Bean lists the price of a pair of gloves as $12.65, in the form you fill in you write the size, and the item number and you send in your check for $12.65. Now what are they going to do if North Dakota is 4 percent, Rhode Island is 6 percent and California is 5 percent plus 2 percent for Los Angeles. That form is going to be very, very complicated because obviously you have got to collect the taxes then. You cannot send the gloves and then subsequently send a bill for the taxes.

Mr. MARTIN. I would like to defer, Mr. Chairman, to Mr. Wisner or Mr. Rothenberg, who is here, who is the executive director of the Federation of Tax Administrators. They are experts on those forms and those procedures.

Senator CHAFEE. All right. We will get to those gentlemen. Let's go with Mr. Glazer, who is president of Bedford Fair Industries, Limited, Mt. Kisco, NY, on behalf of the Direct Marketing Association. Mr. Glazer, we welcome you here.

[The prepared written testimony of Mr. Martin follows:]

National Governors' Association

Lamar Alexander
Governor of Tennessee
Chairman

Raymond C. Scheppach
Executive Director

STATEMENT OF

JAMES L. MARTIN
LEGISLATIVE COUNSEL
NATIONAL GOVERNORS' ASSOCIATION

before the

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
SENATE FINANCE COMMITTEE

on

S. 1510
STATE TAXATION OF INTERSTATE SALES

HALL OF THE STATES · 444 North Capitol Street · Washington, D.C. 20001-1572 · (202) 624-5300

NATIONAL GOVERNORS' ASSOCIATION

NATIONAL ASSOCIATION OF STATE BUDGET OFFICERS

TESTIMONY ON BELLAS HESS LEGISLATION, S. 1510

Mr. Chairman, thank you for this opportunity to present our comments on the issue of state taxation of interstate sales.

The National Governors' Association and the National Association of State Budget Officers strongly support federal legislation that would correct the 1967 Supreme Court decision National Bellas Hess vs. Illinois Department of Revenue and would restore state enforcement power over out-of-state mail order sales. We are asking Congress to simply return to states the taxing powers that existed before federal intervention. The change that we are asking for today is a modest request to strengthen state taxing authority. Here are several reasons why Congress should correct National Bellas Hess:

1. States already have the power to tax goods purchased from outside the state, but are denied the enforcement mechanism to collect the taxes that are due. The judicial interpretation of Bellas Hess created an avenue for legal tax evasion. The customer is still liable for the sales tax on retail goods purchased out-of-state, however, it is virtually impossible for state tax revenue departments to find the customers and assess the tax. In fact, most customers are not even aware that taxes are owed! States have always relied on the help of firms to

collect taxes—whether they be sales taxes, personal income taxes, unemployment compensation taxes, or excise taxes on cigarettes and alcoholic beverages. Today, we are asking Congress to give states the power to enlist the help of out-of-state firms to act as an agent of the state by collecting sales taxes due. Overturning Bellas Hess simply returns a valuable tax collection tool to the states.

It is important to remember that most state sales taxes are levied on the customer—not the retail firm. These sales taxes are then used to purchase public services for those taxpayers.

2. State sales taxes now comprise 32 percent of all state tax collections, and local sales taxes are fast becoming an important revenue source for cities, counties, and mass transportation districts. State and local governments will continue to rely heavily on this tax source to fund the increasing demand for public services—putting tax dollars to work by establishing quality educational systems, providing health care to our aging population, and increasing our infrastructure stock to promote economic development. Overturning Bellas Hess means that state and local governments will collect an additional $1 billion annually in already due sales taxes that can be applied to meeting those public needs. It also plugs a sales tax loophole and broadens the tax base.

States over the past four years have made significant strides in broadening the sales tax base, and many public policy analysts cite this as a move toward improving tax policy. Allowing taxpayers who utilize the fast-growing

out-of-state mail-order sales industry to escape taxation only weakens the sales tax base and increases revenue losses for states.

3. State tax policy should try to provide a "level playing field" for all businesses--and should not provide tax advantages to out-of-state firms. Where possible, competition between firms should be fostered by states--not outlawed. Bellas Hess does just that by giving a clear competitive advantage to out-of-state mail order firms. On the average, goods from mail order firms cost 4.5 percent less than goods purchased from local merchants due to the sales tax differential. Overturning Bellas Hess helps the states restore tax fairness to state sales tax codes.

Tax Administration Issues

The governors and their budget officers recognize that interstate cooperation is necessary to ensure smooth tax administration if Bellas Hess is overturned, and states regain the enforcement authority to tax out-of-state mail order sales. The states are prepared to look at the following administrative issues:

Uniformity of Collection Efforts. Sales taxes are levied in 46 states and each one has its own rules and regulations regarding how the tax is to be collected. The governors would fully support any reasonable proposal to impose uniform reporting and remittance regulations. The governors would be happy to participate in designing such regulations.

The de minimis Rule. The governors also understand that sales tax collection efforts may be overly burdensome to small mail order sales businesses. Common sense dictates that they be exempt from compliance.

Therefore, we support the recommendation of the Advisory Commission on Intergovernmental Relations establishing a $12.5 million de minimis rule. By selecting such a cut-off point, we will relieve small businesses of a significant amount of paperwork, while still capturing the taxes due on the vast majority of sales transactions.

Selection of States Sales Tax Rate. Prior to the Bellas Hess decision, substantially fewer cities and counties had the power to levy sales taxes. Now, due to revenue diversification efforts of state lawmakers, 32 states allow local governments access to this tax source. Consequently, it is now common place for sales tax rates, and sometimes sales tax base, to differ markedly within a state. Therefore, the governors and state budget officers recommend that each state should have the authority to select the uniform state sales tax rate and sales tax base to be used by mail order firms. Each state can best decide whether the rate should reflect the state median or average rate or whether it should be weighted by population. The state can then determine how to distribute the tax dollars back to the cities and counties in the most equitable manner.

Summary

The National Governors' Association and the National Association of State Budget Officers applaud your subcommittee's efforts to help states strengthen their revenue systems. We look forward to legislation that will allow states to once again establish a viable tax collection procedure and stop tax evasion. In this area, if NGA and NASBO can be of further assistance to you or your subcommittee on this important state issue, please let us. Thank you for this opportunity to present state views on S. 1510.

STATEMENT OF ALAN GLAZER, PRESIDENT, BEDFORD FAIR INDUSTRIES, LTD., MOUNT KISCO, NY, ON BEHALF OF THE DIRECT MARKETING ASSOCIATION, ACCOMPANIED BY ROBERT J. LEVERING, DIRECTOR OF GOVERNMENT AFFAIRS AND LEGISLATIVE COUNSEL, DIRECT MAILING ASSOCIATION

Mr. GLAZER. Good morning. My name is Alan Glazer. I am president of Bedford Fair Industries, Ltd., a direct marketing company headquartered in Mt. Kisco, NY. We employ more than 200 people at that location.

Bedford Fair has sales of approximately $25 to $30 million per year. We are typical of the thousands of companies that would be severely burdened by the tax collecting and record-keeping responsibilities which S. 1510 would permit the States to impose upon national direct marketers.

Bedford Fair is a member of the Direct Marketing Association, which is known as the DMA. It is a national trade association representing all facets of the industry, including catalog companies, telemarketers and direct marketing advertising.

I currently serve as president of the DMA's catalog council, but I am here to present testimony on behalf of the association as a whole and its 2,700 members.

The DMA has been asked to present the view of the direct marketing industry concerning S. 1510, but, more generally, concerning the concept represented by S. 1510.

We understand that Senator Andrews has introduced this bill to get the use tax issue on the table and that his intention is to gather information in a series of hearings to see if the practical problems of implementing this type of legislation may be solved by amendments.

The DMA is currently seeking to gather information relevant to that process, including accurate revenue estimates and measures of compliance burdens.

Senator CHAFEE. Mr. Glazer, we are extremely interested in the place in your testimony where you address the specific points. Why don't you drop down to there?

Mr. GLAZER. All right.

S. 1510 attempts to override constitutional principles and would probably be declared unconstitutional by the U.S. Supreme Court. Proponents of this legislation argue that earlier Court cases restricting State jurisdiction over out-of-State companies were based solely on the commerce clause of the U.S. Constituion.

Since Congress does have the power under the commerce clause, it is argued that Congress could then delegate this power to the States, thereby eliminating any constitutional problems.

First of all, the Supreme Court has not relied solely on the commerce power for its decisions in this area. In the landmark *National Bellas Hess* case which was referred to earlier this morning, the Court clearly enunciated a due process test to determine when a State may assert jurisdiction over an out-of-state company.

"The state must have given something for which it can ask return."

The Court also determined that there were no State-supplied benefits flowing to the out-of-State direct marketer which would justify imposing tax collection duties.

Senator CHAFEE. I will tell you, Mr. Glazer, on that particular point, I think in the subsequent hearing we have got to get in a couple of high priced lawyers—I am sure we can find them on both sides—to see how we wrestle with that particular problem. Why don't you move on to your second point.

Mr. GLAZER. Yes, Mr. Chairman.

S. 1510 would unfairly change the ground rules for a significant segment of American business. Under current law, States may not assert jurisdiction over out-of-State companies in the absence of legally sufficient contacts between the State and the company.

The legal term is "nexus." Although courts have been willing to find nexus in some cases on very skimpy contacts, some definite contacts are required to prevent undue interference with interstate commerce and to assure fundamental fairness.

The nexus requirement for State jurisdiction over companies assures at least a modicum of fairness and a quid pro quo for duties imposed. It also generally assures that the company has some property or employees in the State so that it will not be without a voice in the State's political process.

Purely out-of-State direct marketers with no facilities in a State do not benefit from State services such as police and fire protection, roads and bus services; and so on. Instead, they rely on and pay for the services of the United States Postal Service and private carriers. It is no more fair for mail order houses to be required to collect taxes for States from whom they receive no benefit than it is for retail stores to be required to pay for postage for articles sold over the counter.

The next point I would like to make is that in S. 1510 it proposes a sudden and dramatic governmental intrusion into a competitive marketplace, seriously burdening a significant segment of American retailing and having a ripple effect throughout the economy.

Although a full study of likely compliance burdens has yet to be undertaken, it is clear that even minimal costs associated with tracking 46 different tax laws, rates, set of exemptions, filing dates, and communicating tax instructions to consumers and collecting the tax from them would be a shock and a significant one for most companies. In fact, compliance costs are likely to be much more than minimal. And based upon reports from the DMA member companies, many of them would have difficulty either absorbing or passing these costs on.

Senator CHAFEE. Keep going.

Mr. GLAZER. The final point is that the tax collecting authorized by S. 1510 would be extremely inefficient. Early estimates are that in many cases there would be 1 dollar in collection costs for every dollar in revenue collected. Some of these costs are direct governmental expenditures including the cost of enforcing a new and confusing set of requirements on thousands of out-of-state vendors.

The remainder of the costs would be borne by interstate businesses forced to deal separately and individually with 45 different State tax laws.

It should be noted that S. 1510 in its present form would also require interstate vendors to deal with the separate rates and other requirements of over 6,000 local jurisdictions. This is precisely the kind of unproductive interference with interstate commerce that the Founding Fathers took pains to prevent by draftinq the commerce clause of the U.S. Constitution.

Even for a State like North Dakota with only a handful of direct marketing companies, the revenue attractions of this legislation are very slight. For the vast marjority of States with dozens or even hundreds of direct marketing companies within their boundaries, small tax revenue gains would be more than offset by the negative impact that this proposal would have on the State economies.

As the representative of the industry which would be most directly and seriously injured by this proposal, the Direct Marketing Association urges this subcommitte to consider seriously the broad range of consequences which would result from any legislation along the lines of S. 1510.

Data is being gathered concerning the serious practical problems of implementing this type of proposal, but in deciding whether or not an exception should be made to the due process concept of fundamental fairness, it should not be necessary to answer the questions: How much tax revenue are the States going to receive? Or how much of a burden will this put on interstate sellers? There are problems with use tax collection, but none that require a special grant of constitutional authority to the States.

I thank you for your consideration of the views of the Direct Marketing Association and its members. Thank you.

Senator CHAFEE. Well thank you very much, Mr. Glazer. You have touched on some of the problems that clearly are going to trouble us. I am not going to dwell on the constitutional ones because that is something I am sure we can get opinions on both sides. But I would like to touch briefly on the dramatic government intrusion into your business and the inefficiency of the tax collection.

I would like you now to address this—issue it may be difficult for you—with the view that we are going to do it, but in the least intrusive way and the most efficient way which should cause you and the members of your organization the fewest problems.

It seems to me that the points you make about the 6,000 local jurisdictions and the difference in what is exempt and what is not are very valid points.

How do the major direct mailers do it now—Sears, for example—when they are subject to these taxes because they have a place of business in the State? Now I know Sears is a giant, and I suppose Sears can do most anything. But still they have to wrestle with this problem. How do they do it?

Mr. GLAZER. Well it is difficult to speak for Sears as much as I would like to, as president. But trying to put myself in their shoes, the majority of their sales are through retail outlets and not through the mail order, as amazing and as enormous as their mail order sales are.

Therefore, I would conclude that they are willing to absorb a certain burden because the benefit is that they do have a retail presence in that State.

Additionally, if my understanding is correct, I don't believe that Sears even has an order form in their catalog; that many of their sales are developed by an individual going to the store and picking up the merchandise. At that point, it can be charged to a Sears account or it can be paid for in cash or the merchandise is not imparted to the customer.

I believe many of their sales are concluded in that manner. But I would come back to the point that there are a handful of companies that are in the mail order industry who have a presence in 30, 40, or 50 States and who derive tremendous benefit from being in those States, and are therefore, I assume, willing to absorb the burden, the cost, the lack of taxes which cannot be collected on a mail order sale in return for the fact that they are doing business in that State, and they are obtaining value in that State.

I would like to also add that among the more medium size companies, of which there are perhaps two dozen who have stores in perhaps two dozen States or a dozen States, they have found that the mailing of catalogs to people in those States as often as not will drive customers into the stores in those States to pick up an item which they have seen in the catalog that evening. At that point, as long as the customer is in the store, the collection of the sales tax is a relatively easy matter, as opposed to the customer trying to mail back to the home office in yet a different State.

It is not uncommon for the handful of giant mail order companies to spend literally millions of dollars on computer systems in an attempt to solve this problem. This is something that the major proportion of mail order companies cannot afford to do or cannot handle.

Senator CHAFEE. Do you agree with the statistic that Mr. Martin gave, that if we have the de minimis test of $12.5 million there would only be 200 direct mail outfits affected?

Mr. GLAZER. I would disagree with it very strongly. I have something of a dilemma in that I represent a company as well as an association this morning, and the association is made up of small companies as well as larger ones. So the next statement I make is as a company president and not for the DMA.

If you were to have any de minimis, whether it be 5 million, 10 million or 15 million, when a catalog from a small company, so-called small company, and a catalog from a medium company were to arrive in the same household on a given day selling similar goods, and the order form requested a sales tax from one and the other catalog did not choose to collect a sales tax, or was not required to collect the sales tax, how would you as a consumer react to that? What would be your thoughts about the company attempting to collect the sales tax and your thoughts about the one that did not require or have to collect the sales tax?

Both are substantial companies. One may be $8 million in sales and the other may be $12 million. I think it presents a dilemma for the slightly larger company.

Additionally, I think that because of the enormous burden of implementing this tax and collection procedure, and given the fact

that most of the companies in this industry are small to medium size, such as our own, which are entrepreneural in nature, we have as an industry and as individual companies provided tremendous net gains in employment over the last 10 years, more so than the larger Fortune 500 companies in our country.

What would you do as the owner of a company approaching the level or the brake in de minimis? Would you grow your company or would you step back and say is it worth incurring this tremendous tax burden if I can stay as a smaller size firm?

Senator CHAFEE. Well I think those are good points.

Senator Andrews, do you have a question?

Senator ANDREWS. Yes. I would like to examine your context or your statement that your type of firm does not benefit from fire protection, police protection, roads and bus services, and therefore, should not collect taxes. That's very true, Mr. Glazer. Absolutely true, that you don't benefit from that. The point is, however, that your customer does. And the customer is paying the tax, not you. And the customer resides in that State and derives benefits from the school system, police system, the road system, and all of the rest. And if that customer does not pay for what they derive benefits for, then other neighbors are going to have to pay that much more.

How do you respond to that fact that you seem to have in your testimony completely overlooked? The tax is not on you but it is on your customers who do derive those benefits. Or do you maintain that the individual who buys from a mail order house does not derive benefits from the local police and fire protection and local school system?

Mr. LEVERING. If I might, Senator Andrews, answer on behalf of the industry.

Senator ANDREWS. Sure.

Mr. LEVERING. Two answers to the question. First of all, the mail order customer, as a mail order customer, does not derive any specific benefit (from State services), in the same way that, for instance, a customer of a local department store would when he is actually making the transaction: the trip to the store, when he is actually in the store. Both the retailer and the customer at that point are benefiting from all of the State services that you mentioned.

But in addition and probably a more basic point, your bill, Senator, is addressed to the collection problem. And you already have tax laws that specifically say that the customer should pay the tax. What we are talking about here and the issue you have brought before the Congress is, should out-of-State companies be required to collect the tax. And you cannot just bootstrap benefits to one group so that you can get jurisdiction over the other group.

Senator ANDREWS. No. But you completely backed away from the point, that these benefits are benefits that your customers get. And they are not benefits that you get, but your customers get those benefits. And fair play cries out for the fact that these customers should pay the tax. That is a tax on them.

The whole context of this presentation by Mr. Glazer is that somehow or another we are trying to tax the retail mail order firms. Nothing could be further from the intent of those of us who

put this bill together. We are trying to make sure that the customer pays their proportionate charge for the services that they do derive benefit from.

As a matter of fact, when you talk about cheap ability to go to the local store, it is cheaper for the customer to order from the mail order house than it is to drive 15 miles to the local store. So they do not derive any benefit from that.

Let me ask just one final question. I know, Mr. Chairman, that time is of the essence and we want to make as complete a record as we can. You maintain, Mr. Glazer, that there is $1 collection cost estimated for every dollar of tax revenue you are going to collect. Could you provide the committee with the back up for that? That seems pretty high. It seems sort of a pie-in-the-sky, to put it candidly. And I am sure you have very solid backup for that, and it must be based on experience of collection that Sears & Roebuck, and J.C. Pennys and the rest have. So if we could have the documentation for that, it would be helpful.

Mr. LEVERING. That statistic comes from some reports from the smaller and mid-sized companies.

As you know, there are no statistics on either side at this point that could be called credible. We have anecdotal evidence from companies. The cost for some, even companies larger than Mr. Glazer's, that report over a dollar collection cost for every dollar of tax collected, based upon their own analysis of what they would have to do in order to collect it. And there is one big problem in the mail order industry that sometimes up to 50 percent of all payments are by check, and if the customer does not pay the tax in a retail store he does not get past the cash register. But the mail order houses are between a rock and a hard place. They either have to refuse the order, try to track down the tax, or eat it themselves. And factoring in that particular large cost item, it is fairly easy to believe that even the costs for the mail order houses themselves would be $1 for $1, and this not even counting any of the pretty unmeasurable costs of government collection and tracking down out-of-State vendors and trying to make sure that the taxes are collected.

Senator ANDREWS. No, but you must, Mr. Levering. Actually, the statement is Mr. Glazer's; but you must have the definitive backup to make that kind of a statement.

All we are looking for is the definitive backup. So, if you can point out to the committee why it would cost a dollar to collect a dollar's worth of sales tax on these kinds of orders—and you must have that documentation—we would be glad to have that.

Mr. LEVERING. Yes. Well, the statement that is made is supportable in cases reported to us.

Senator CHAFEE. All right. Why don't you just send us in the poll of your members or something, so that we can have something on the record?

[The prepared information follows:]

Supplemental Submission for the Record

Hearing on S.1510 before the Senate Finance Subcommittee on Taxation and Debt Management, November 15, 1985

This supplemental statement is submitted by the Direct Marketing Association at the direction of Chairman John Chafee in answer to a question from Senator Mark Andrews. Senator Andrews' question referred to the following statement in the DMA testimony: "The tax collecting authorized by S.1510 would be extremely inefficient. Early estimates are that, in many cases, there would be one dollar in collection costs for every dollar in revenue collected." The testimony goes on to explain that some of the costs would be state government expenses of attempting to collect the tax and the remainder would be costs borne by interstate businesses. Senator Andrews asked about the basis for these early estimates of compliance costs.

Efforts by the DMA to quantify compliance costs associated with this legislative proposal are currently underway. In the meantime, compliance cost estimates are based upon testimony submitted by DMA members to the Advisory Commission on Intergovernmental Relations last spring when the ACIR was considering a recommendation on this issue. Every single one of the over 50 submissions by direct marketing companies mentioned large compliance burdens. Most of the testimony in this regard was non-quantitative because of the difficulty in predicting the exact size and nature of cost elements. The following comment was typical: "The costs of keeping track of the tax rates, filing dates, and exemptions in 46 states is impossible to calculate because of the complications involved. But it will certainly be significant." (testimony submitted to the ACIR on April 3, 1985 by NASCO of Fort Atkinson, Wisconsin).

However there were several companies that took the time to estimate their compliance costs. It is appropriate in answer to Senator Andrews' question that portions of their testimony to the ACIR be included in this hearing record:

1. "It is our estimation that this ruling will increase operating costs by as much as 10 percent to as much as 12 percent of gross sales. No company can absorb that increase without raising prices." (ACIR testimony of American Products, Chicago, Illinois) Note: Since tax rates for state use taxes are less than 10 percent of sales, collection costs in this particular instance would be greater than tax revenues.

2. "We estimate that administering the program proposed by the ACIR staff report on State and Local Taxation of Interstate Mail Order Sales could cost Prudent Publishing an additional $200,000 to $300,000 annually, plus initial start-up costs." (ACIR testimony of Prudent Publishing Company, Englewood Cliffs, New Jersey). Note: Earlier in the testimony, Prudent Publishing indicated that they are a mail order firm with sales under $10 million a year. Thus, collection costs (even without including start-up costs) would be at least two to three percent of gross sales.

3. "The estimated minimum cost to comply with the study totals $125,822.80. This does not reflect the percentage of projected sales, but are, in fact, hard costs." (ACIR testimony of Hawaiian

Holiday Macadamia Nut Co., Honolulu, Hawaii). Note: The company's testimony indicates they have an overall mail order sales volume of $2.35 million yearly. Thus, compliance costs for use tax collection would be approximately five percent of sales or slightly more than the average sales tax.

4. "Thirteen percent of our Colorado orders had no sales tax added. These orders accounted for only nine percent of the dollar volume, but 93 percent of such orders were cash orders and did not allow us the opportunity to bill a customer for the tax at the time of invoicing the order. For our fiscal year ended June 30, 1985, our Colorado sales were $1,903,784 on 49,042 orders which averaged $38.00 each. At a sales tax rate of three percent (very low as compared to most states, we may add) on nine percent of our Colorado sales, we ate approximately $5,132.00 rather than collecting it from our customers because the cost of collection far exceeds the payment of the tax. We do this as standard operating procedure in Colorado because we are subject to the state as a domestic corporation." (Supplemental ACIR testimony of Current, Inc., Colorado Springs, Colorado). Note: In an earlier submission, Current documented direct costs of pursuing unpaid taxes to be $1.47 on the average order, excluding fringe benefits, computer rental occupancy costs, and overhead. Because Current's sales are primarily "cash with orders" (89.8 percent of sales in 1984), this is a significant item for Current. This one cost element alone would amount to between $340,000 and $460,000 a year, the company estimates.

Complete copies of these submissions to the Advisory Commission on Intergovernmental Relations are available upon request. In addition, DMA is in the process of doing a systematic analysis of compliance costs for different types of direct marketers. We hope to have the data available by March of 1986.

Respectfully submitted,

Robert J. Levering,

Director of Government Affairs

and Legislative Counsel

Senator CHAFEE. In response to the point that you made, Mr. Levering, that if they don't include it, you don't know what to do—whether to send it back, to eat it, or to collect it yourself, or how to handle it—isn't this true in anything you mail out? You send out a charge for a new generator for $460.00, and the person sends you back a check for $452.00; they just thought they wouldn't pay the remaining $8.00.

Now, there you have the same problem. What do you do? Do you eat the $8.00 since you are glad to have the order, and forget it? Presumably, the same thing would work out. If you have to collect a 5-percent sales tax on the order, or whatever it is, and the person doesn't send in the 5 percent, you have a choice as to whether to send the goods or not. It would be just as if they hadn't paid the right amount for the goods in the beginning.

Mr. GLAZER. Senator, if I may answer that question and adapt it a little bit, I would point out that we ship approximately 1 million garments per year. Forty percent of our orders are under $40 in average; and this is based on sales statistics for a recent 6-month period. If you were to assume that, among that 40 percent of sales that are under $40 that the average order is perhaps $30 and that the sales tax on that at 5 percent is $1.50, if a customer decides not to include the $1.50 with the order, yes, we have to make a choice whether to chase the customer with U.S. postage, record that order in the computer, keep it in the pending file, go—in opposition to what we have based our reputation on, which is rapid fulfillment of orders, and which has made this industry successful today; and

now we begin an entire series of correspondence with the consumer, or we elect to forget the $1.50 and ship anyway, with a note on the invoice that says please remit the $1.50 for sales tax.

In that case, if the customer chooses after receiving the merchandise in her home State to not remit the $1.50, it is gone forever. That $1.50 is 5 percent of gross sales. For some companies—for perhaps a lot of companies—that represents pretax profit on that sale.

Senator CHAFEE. I understand that, but don't you get the same problem——

Mr. GLAZER. Not at all.

Senator CHAFEE. Suppose I should choose to just chintz you 5 percent on every order I make? If the order is $40, I just think I won't send it in?

Mr. GLAZER. It generally doesn't because the price is clearly stated, to which one adds the postage and handling charges; and one must then add it up and that is the price.

Senator CHAFEE. Suppose I said the heck with it and I will just let you pay the postage and handling charges? You wouldn't do it. You would say I am not entitled to that dress or whatever it is that I have ordered.

Mr. GLAZER. The facts of it are such that we will allow a certain underpayment because of the cost of losing the order, not because it is any longer profitable. It is not profitable at that point, but there is a very substantial and basic difference between retailing and mail order companies, which I think has to be understood.

A retailer puts merchandise in his store in anticipation of demand. A mail order company puts merchandise in his warehouse and then goes out and creates demand with a tremendous up-front expenditure in catalog printing and mailing costs and must then receive the order in, in order to reimburse himself or herself for that up-front expenditure.

In that regard, every order that comes in has to pay its way; and when the order comes in, it may be short $1.50 or $2. The inclination is that having part of it is better than having none of that.

Senator CHAFEE. We won't let that go further than this room, Mr. Glazer.

Mr. GLAZER. I do appreciate it, Senator. [Laughter.]

Senator CHAFEE. Now, Mr. Glazer, let me ask you something else. You have discussed equity in here. What are we to do about this situation? Your industry is not just a little part of the total; you are a big part. You are not only big in percentage terms—as Senator Andrews said, you have 15 percent of the market and will have 20 percent by the end of the decade—but in dollars, you have $60 billion in sales.

So, your industry isn't some little rinky-dink operation. You are a big factor in retail sales; and for you folks to be exempt from the sales taxes to me just doesn't seem to be fair.

Mr. GLAZER. Well, if I could answer in this way: First of all, putting the constitutional questions aside which we have agreed to do, the complexities of implementation of virtually—I would border on saying—impossible or cost efficient. It was suggested earlier that this is unfair to in-State retailers, that is to have a company sitting outside the borders, mailing in, taking an order, and then customers are purposely perhaps buying from a mail order company to

save the 5-, 6-, or 7-percent sales tax that their particular State imposes on its residents.

I would like to point out that, for virtually all mail order companies, there is a shipping and handling charge tacked onto the order which is probably greater than, in percentage form, the 5 or 6 percent of the State's.

So, I don't believe that somebody is buying a $20 or $30 dress from us as compared to a local retailer in order to save the 5 percent. In buying from us, they are adding 10 percent for postage and handling charges; and if anything, they are paying, a premium. I think that people are buying from mail order companies, Mr. Chairman, for reasons other than tax considerations.

Senator CHAFEE. I agree with that. I don't think we want to get into the comparisons of the shipping and handling charge versus having a downtown establishment that has to pay real estate taxes and has to have a store front and manikins and all that goes with it because back and forth we can go on this discussion.

You do not have to have carpets and nice lighting and all that in your warehouse. So, I don't think we get very far by saying that you are burdened with certain expenses and they are burdened with other expenses. I am sure that we could get all kinds of testimony that their burden was just as large with certain expenses, vis-a-vis what you have.

We are dealing with a big sum here. I think Senator Andrews has well pointed out that the $60 billion in sales ends up with $1.65 billion of lost taxes. This is a very sizable amount. He stated in his own State it was $30 million. Is that what you said?

Senator ANDREWS. $30 million in my own State.

Senator CHAFEE. That is $30 million a year; and somehow, for certain retailers to be exempt from sales taxes strikes me as unfair.

Senator ANDREWS. Let me point out another thing because Mr. Glazer has just brought up something that I hadn't even thought of; and it is amazing when you get into this.

I remember these mail order blanks. You put on them shipping charges by zone; and somehow or another, you sort your way through the fact that one State pays one shipping charge, another State pays another shipping charge, and another State pays yet another shipping charge. You have been able to do all of that; and as Senator Chafee points out, if somebody tries to "stiff" you on the shipping charge, you may or may not send the piece of merchandise. That is a decision that you can make.

You also pointed out that you maintain the inventory; but that is something that I recall that, when we send the order in, we get that little note back that says sorry, we are temporarily out of stock. We will send you this merchandise in 60 days. You don't even maintain an inventory. So, I would think that for being able to get into some of these States, you could at least be a good enough citizen to collect the taxes from the individual—not pay the taxes. And I think we want to make it crystal clear that this bill does not have the direct mail order sales firms pay any additional taxes because you don't derive services.

All we are saying is that, in equity and fair play, your customers should pay the taxes for the services that they do get and they derive. Then, we have a level playing field.

Mr. GLAZER. In the name of equity and fair play, if I may respond to your comments——

Senator ANDREWS. Surely.

Mr. GLAZER. First of all, I hope that our good citizenship is not in question this morning or any morning.

Senator ANDREWS. Oh, no, no.

Mr. GLAZER. Additionally, I would estimate that less than two dozen nationally known, gigantic, billion dollar plus mail order companies maintain a zone chart which takes up almost a page of a catalog by itself. The vast majority of the mail order companies charge a uniform rate, based on the dollar value of the purchase made.

They perhaps lose money on shipments made across the country, and they perhaps break even on shipments made nearby to neighboring States. So, they don't have these charts because every square inch of a catalog must bear its cost, just like very square foot of a retail must bear its cost or its burden and develop sales.

As for the inventory issue, and do we maintain an inventory? Yes, we do send out our share of little delay cards that say we don't happen to have your color or size. I will tell you—and I will share with you this morning—that we have a quarter of a million garments in stock at any given time, amounting to a cost of millions of dollars; and any suggestion that we wait for the order before we make the goods is taking liberties.

Senator CHAFEE. All right, fine. Thank you very much, Mr. Glazer. You have had an active role here this morning.

Mr. GLAZER. I appreciate the opportunity, Senator.

Senator CHAFEE. As I said, I suspect in our next hearing you will have some allies. Are you the major organization for the direct marketing group?

Mr. GLAZER. I would say so.

Senator CHAFEE. Would most of them belong to your organization—the big ones and little ones and medium ones?

Mr. LEVERING. Most of the big ones belong to DMA. We have 2,700 members. There are over 10,000 directly affected catalog and other direct marketers in the country; and they are not members, but some of them are small and some of them just haven't joined yet.

Senator CHAFEE. All right. Fine. Mr. Wheeler.

[The prepared written statement of Mr. Glazer follows:]

TESTIMONY
OF THE
DIRECT MARKETING ASSOCIATION
BEFORE THE
SENATE FINANCE SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT

delivered by

Alan Glazer

President

Bedford Fair Industries, Ltd.

NOVEMBER 15, 1985

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Good morning. My name is Alan Glazer. I am President of Bedford Fair Industries, Ltd., a direct marketing company headquartered in Mt. Kisco, NY, where we employ more than 200 people. Bedford Fair had sales of between $25 and $30 million last year. We are typical of the thousands of companies that would be severly burdened by the tax collecting and record keeping responsibilities which S.1510 would permit the states to impose upon national direct marketers.

Bedford Fair is a member of the Direct Marketing Association (DMA), a national trade association representing all facets of the industry including catalog companies, telemarketers, and direct response advertisers. I currently serve as President of DMA's Catalog Council, but I am here to present testimony on behalf of the Association as a whole and its more than 2700 members.

DMA has been asked to present the views of the direct marketing industry concerning S.1510, but more generally concerning the concept represented by S.1510. We understand that Senator Andrews has introduced this bill to get the use tax issue on the table and that his intention is to gather information in a series of hearings to see if the practical problems of implementing this type of legislation may be solved by amendments. DMA is currently seeking to gather information relevant to that process including accurate revenue estimates and measures of compliance burdens. We will be happy to share the results of these efforts with Senator Andrews and with the subcommittee.

In the meantime, we are happy to have the opportunity to comment on the general concept embodied in this legislative proposal. This proposal calls for circumventing a U.S. Supreme Court decision and granting states the power to require out-of-state businesses to collect state use taxes. We believe that apart from the many practical problems with this proposal (which may themselves be insurmountable), the concept of the federal government giving states jurisdiction over out-of-state businesses for tax collection purposes is constitutionally and economically unsound and not in the national interest.

Here then are four problems which would apply in varying degree to S.1510 no matter how it might be amended to address problems of practical implementation:

1. S.1510 attempts to override constitutional principles and would probably be declared unconstitutional by the U.S. Supreme Court. Proponents of this legislation argue that earlier Court cases restricting state jurisdiction over out-of-state companies were based solely on the Commerce Clause of the U.S. Constitution. Since Congress does have the power under the Commerce Clause, it is argued that Congress could then delegate this power to the states, thereby eliminating any constitutional problems.

   First of all, the Supreme Court has not relied solely on the Commerce Power for its decisions in this area. In the landmark National Bellas Hess case (387 U.S. 753) the Court clearly enun-

ciated a Due Process test to determine when a state may assert jurisdiction over an out-of-state company: "the state must have given something for which it can ask return." The Court also determined that there were no state-supplied benefits flowing to the out-of-state direct marketer which would justify imposing tax collection duties. Since Due Process principles of the Constitution apply to Congress as well as to the states, the substance of S.1510 could not be enacted without a constitutional amendment.

Even if the Supreme Court would defer to Congress in the Due Process area as it has been done in the Commerce Clause area (a highly unlikely prospect), the question would remain why would Congress want to tamper with these constitutional principles. There are good reasons why the Constitution has heretofore required fundamental fairness in state government dealings with persons and corporations. There are good reasons why the Constitution has heretofore prohibited state interference with interstate commerce. And there are good reasons why the Constitution has heretofore prohibited taxation without representation. It is doubtful whether any state revenue need, no matter how compelling, would justify altering these basic principles; and as we shall see, there is no such compelling need in this case.

2. S.1510 would unfairly change the ground rules for a significant segment of American business. Under current law states may not assert jurisdiction over out-of-state companies in the absence of legally sufficient contacts between the state and the company. The legal term is "nexus." Although courts have been willing to find nexus in some cases on very skimpy contacts, some definite contacts are required to prevent undue interference with interstate commerce (Commerce Clause) and to ensure fundamental fairness (Due Process Clause).

The nexus requirement for state jurisdiction over companies assures at least a modicum of fairness, a quid pro quo for duties imposed. It also generally assures that the company has some property or employees in the state so that it will not be without a voice in the state's political process. Purely out-of-state direct marketers with no facilities in a state do not benefit from state services such as police and fire protection, roads and bus services, etc. Instead they rely on (and pay for) the services of the United States Postal Service and private carriers. It is no more fair for mail order houses to be required to collect taxes for states from whom they receive no benefit than it is for retail stores to be required to pay postage for articles sold over the counter.

3. S.1510 proposes a sudden and dramatic government intrusion into a competitive marketplace, seriously burdening a significant segment of American retailing and having ripple effects throughout the

economy. Although a full study of likely compliance burdens has yet to be undertaken, it is clear that even minimal costs associated with tracking 46 different tax laws, rates, sets of exemptions, filing dates and communicating tax instructions to customers and collecting the tax from them would be a shock, and a significant one, for most companies. In fact, compliance costs are likely to be much more than minimal and based upon reports from DMA members companies, many of them would have difficulty either absorbing or passing on those costs.

4. The tax collecting authorized by S.1510 would be extremely inefficient. Early estimates are that in many cases there would be one dollar in collection costs for every dollar in revenue collected. Some of these costs are direct government expenditures including the cost of enforcing a new and confusing set of requirements on thousands of out-of-state vendors.

The remainder of the costs would be borne by interstate businesses forced to deal separately and individually with forty-five different state tax laws. (It should be noted that S.1510 in its present form would also require interstate vendors to deal with the separate rates and other requirements of over 6000 local jurisdictions.) This is precisely the kind of unproductive interference with interstate commerce that the founding fathers took pains to prevent by drafting the Commerce Clause of the U.S. Constitution.

Even for a state like North Dakota with only a handful of direct marketing companies, the revenue attractions of this legislation are very slight. For the vast majority of states with dozens or even hundreds of domiciliary direct marketing companies, small tax revenue gains would be more than offset by the negative impact of this proposal on the state economies.

As the representative of the industry which would be most directly and seriously injured by this proposal, the Direct Marketing Association urges this Subcommittee to consider seriously the broad range of consequences which would result from any legislation along the lines of S.1510. Data is being gathered concerning the serious practical problems of implementing this type of proposal, but in deciding whether or not an exception should be made to the Due Process concept of fundamental fairness, it should not be necessary to answer the questions: How much tax revenue are the states going to receive? or How much of a burden will this put on interstate sellers? There are problems with use tax collection, but none that require a special grant of Congressional authority to the states.

I thank you for your consideration of the views of the Direct Marketing Association and its members.

STATEMENT OF ARTHUR W. WHEELER, PRESIDENT, NORTH DAKOTA RETAIL ASSOCIATION, BISMARCK, ND

Mr. WHEELER. Mr. Chairman, good morning. It is a pleasure to be a part of this hearing this morning. First of all, Senator, let me congratulate Senator Andrews on the foresightedness he had in the introduction of S. 1510.

Certainly, he is recognizing a consumer trend that is worthy of considerable attention, and the North Dakota Retail Association, all of our retailers, and business people across the Nation, Senator, are extremely proud of the bill that he has introduced. I might point out, Mr. Chairman, that retailing this morning is sitting on the same side of the table and sitting next to our opponents on S. 1510, and I think in this spirit, Mr. Chairman, this whole problem can be alleviated. We would like to address for just a few moments this morning some of the mechanics and the problems that you have talked about because I have given you a copy of written comments, of course, that will address some of the dollars and cents issues.

But we need the help of Congress to allow us to be able to sit around the table, Mr. Chairman, and address the problem. Since 1967, the Supreme Court has said no, you can't require direct marketers to collect and remit sales tax because they don't have a presence; and we are asking your subcommittee and the Senate Finance Committee and Congress to adopt legislation allowing us to find answers to these particular problems.

It is extremely important that there be equity in the business community across our Nation. To address some of the concerns of the mechanics of what would happen if Congress did adopt a bill to overturn *National Bellas Hess*, let me get into several of the mechanical factors.

We have found in the business community and across the Nation that if we sit down with tax people, the people who implement the requirements of law, we can certainly find solutions that are going to be workable—solutions that will certainly provide answers to the problem.

Direct marketers assert that they cannot comply with the levels of tax from approximately 7,000 taxing authorities. Our retail association and retailers across the Nation have strongly felt that there need to be provisions from each State legislature that there be a common, universal rate across North Dakota. We know that there are a lot of local taxing authorities; but with the universal rate, we simply reduce the number of taxing authorities from that 7,000 down to the number of 46—those State authorities that do have sales taxes now.

Each State, of course, that is concerned about local taxing authorities then, within their own legislative powers, Mr. Chairman, could redistribute the revenues that they do receive from direct marketers. That can be a State issue.

Third, any money that a local taxing authority might gain from the State legislative action is a gain over the inequities that they now have. Direct sellers will assert that there is no commonality of taxing base. Again, the combination of State taxing authorities should be able to agree on generally common tax bases, such as ap-

parel or clothing, all tangible items, things of a gift nature whether they be electronic. I don't think that that is an insurmountable problem.

Yes, States have made distinctions as to what a taxing base is, but again, there is room for discussion and agreement that, if we are going to have this provision where States can require direct sellers to collect and remit sales tax, we will find a common taxing base.

A line item on the order blank would be if you are a resident of North Dakota, then if it is a tangible item and not a food item, then of course you will pay the sales taxes indicated on a particular rate. Direct sellers will advocate that the administrative cost of collecting sales tax will reduce their profitability to zero and may force them to raise their consumer price.

Mr. Chairman, that is certainly no different a situation than the 6,000-plus retailers in North Dakota who, every day when they open their doors and sell something off the shelves, know that tbey have to collect the sales tax if it is a taxable item. We think that, while the direct marketers will complain about the administrative cost, they should be entitled to the same State privileges of a vendor's allowance, if the State has legislated one, as State retailers are.

North Dakota allows 1½ percent of each sales tax dollar collected as a reimbursement to the retailer collecting that tax for administrative costs incurred.

Certainly, those out-State retailers should be allowed to help defray their administrative costs in the same manner as anyone else would. I might point out as well that any nonresident of North Dakota who is a transient merchant selling in our State is required to collect sales tax and is entitled to the same reimbursement allowance as we would expect a direct marketer to be entitled to as well.

Direct sellers, Mr. Chairman, have dramatically tapped a very precious market. That market is the same source of disposable dollars that economically turn sufficiently in local communities to pay salaries, support schools, cities, and counties. We believe that each dollar spent with a direct marketer has a triple disastrous effect on in-State sales, especially now in North Dakota when competition is keen and we see an influx of 40 to 50 different catalogs every month coming into our State, into our homes, into our business places. There is a need for equality in the marketplace.

We recognize that, as technology grows, not only will we have printed catalogs, Mr. Chairman, but we will have visual catalogs brought into each home via cable TV with ordering capabilities simply by dialing an 800 number. Consumerism dictates that is the fastest growing retail marketplace in our Nation, and we must address this problem, Mr. Chairman.

Please, Mr. Chairman, we ask you to lend your support to S. 1510. Help each State's retail community stand tall and financially independent. We are concerned about the incentive of our people who have hundreds of thousands of dollars of inventory in their stores every day when they open; and it is hard to tell them to be optimistic and to continue to employ people and pay salaries if they see someone else getting an unfair competitive advantage.

It has been my pleasure to be with you this noon, Mr. Chairman.

Senator CHAFEE. Thank you very much, Mr. Wheeler. We will get back in a few moments to questions of the whole panel.

The next witness is Mr. J. Basil Wisner, who is the deputy comptroller of the State of Maryland and president of the National Association of Tax Administrators. You have Mr. Rothenberg with you, who is the executive secretary of the National Association of Tax Administrators. I also want to point out that Mr. Gary Clark, the tax administrator from my home State of Rhode Island, is here. We are glad, Gary, that you have taken the trouble to come down, and we hope that you find this testimony helpful.

Mr. CLARK. Thank you very much, Mr. Chairman.

Senator CHAFEE. Mr. Wisner, why don't you proceed?

[The prepared written testimony of Mr. Wheeler follows:]

PREPARED TESTIMONY

TAXATION & DEBT MANAGEMENT SUBCOMMITTEE
SENATE FINANCE COMMITTEE

HONORABLE JOHN H. CHAFEE
SENATOR, RHODE ISLAND
CHAIRMAN

NOVEMBER 15, 1985

PRESENTED BY:

ARTHUR W. WHEELER, PRESIDENT
NORTH DAKOTA RETAIL ASSOCIATION
206½ NORTH SIXTH
BISMARCK, NORTH DAKOTA 58501

Thank you for this opportunity to present testimony to the Subcommittee on why S. 1510 should be adopted by the United States Congress.

My comments should be received as reflecting not only the 900 retailers in North Dakota that are members of the North Dakota Retail Association, and sales tax collectors all, but hopefully, and more generally, synonymous with the concerns of all general retailers across the United States.

S. 1510 will provide equity amongst the nationwide retail community. In North Dakota, every merchant who sells a taxable item must collect and remit sales tax on the value of that sale. That is also true in every other state that has a sales tax, too. It certainly is not fair for a Direct Seller to enjoy a nationwide market without playing by the same rules.

We ask your help in correcting that injustice.

"De Minimis Rule"

Our research has revealed no taxing authority, state or local, that employs a "de minimis rule" for the application of sales tax rates. Therefore, it is contrary to fair and equal tax treatment principles to recognize a "threshold" of sales at which an outstate seller would be liable for tax collection.

WE recognize that the greatest percentage of sales tax collections (about 75% in North Dakota) come from about ten percent of those collecting the sales tax. However, total sales volume should not be an excuse for hot collecting a just sales tax.

In an attempt to not be unfair in the application of S. 1510, we agree that a "de minimis" threshold of $5 million dollars in annual sales volume is equitable. Every direct seller who accomplishes that annual sales level, nationwide, should be required by each state taxing authority to collect and remit sales tax to the state from which the sale originates.

We do feel that a "de minimis rule" would increase the compliance cost of outstate catalog marketers near the "de minimis" level. Re-printing costs of catalogs and order blanks would far outweigh actual compliance costs of sales tax collections. In an effort to not force undue compliance costs on legitimate "small direct sellers", the retail community will not oppose a "de minimis rule" as part of the adopted law.

Compliance Costs

In North Dakota we've based all of our compliance cost concerns on the 1982 Peat, Marwick & Mitchell study conducted for the American Retail Federation. Since our

state was not a part of that study, we've selected Missouri compliance costs as being most similar to costs in North Dakota for sales tax collection and remittance. The taxing base is the most alike of all seven states studied.

Compliance costs average 4.11% of each sales tax dollar collected, not total sales, by North Dakota merchants. That cost will vary proportionately to total sales volumes, but the 4.11% compliance cost relates primarily to firms with sales exceeding $10 million per year. Compliance costs for firms with sales from $1 to $10 million annually can average near 4.35% per sales tax dollar collected and almost 6.72% for each dollar collected for retailers with less than $1 million per year in sales.

We expect that outstate catalog marketers would have to implement computerization or other procedures to collect sales tax on mail orders and properly record that information. As you are well aware, other outstate catalog marketers currently domiciled within a state boundaries are doing that now. That amortized cost should be considerably LESS than the 2.41% cost per sales tax dollar collected our retailers incur in the ACTUAL COLLECTION PROCESS at the point of sale.

Reducing that highest single compliance cost factor, alone, provides for LESS TOTAL compliance cost for outstate marketers than what our retailers incur daily on every transaction.

Compliance costs for outstate marketers would also be less than the 4.11% figure we use in North Dakota because adjustment costs related to returned merchandise should be less. I would anticipate the degree of returned merchandise to be far less for outstate marketers than instate sellers simply because of the inconvenience of returns for merchandise purchased outside of North Dakota.

Abnormally high compliance costs can be reduced through outstate marketer - state mutual agreements on collector's allowances (also called vendor's allowances) to maintain equity treatment for all collectors, instate as well as outstate.

Multiple Jurisdictions

Much has been said about the complexities of multiple jurisdictions.

The forty-six (46) state, including D.C. taxing authorities currently have rates that consolidate into thirteen (13) different rate levels. Only nine of the forty-six authorities have individual rate levels not common with another authority. Thirty-seven (37) authorities share only FOUR rate levels. The median rate happens to be 4.75% and the average rate is 4.5%.

The point is this. Outstate marketers should be able to incorporate an applicable state rate schedule or chart on their order blank. This could be very similar

to what each marketer now does with consumer notification of finance charge rates on Revolving Charge accounts. On those schedules, marketers are disclosing information on fifty (50) state authorities including as many as thirty (30) rate levels in a space of 3½ by 4 inches.

When S. 1510 is adopted and implemented, each state taxing authority should be granted state legislative authority to certify to each outstate catalog marketer on a periodic basis agreed upon, a statewide universal rate. Those same state authorities should be able to either determine pro-rated allocations back to local taxing authorities if the need arises because of local sales taxes, OR, jackpot local tax shares for distribution by legislative authority. After all, something gained through a universal rate is better than the "status quo".

We do not support including the Federal Government in the collection of sales tax due individual states. Remittance of sales tax by outstate sellers to individual states should be accomplished by mail remittance on a monthly or quarterly basis just as it is currently with instate sales tax collectors.

Additionally, the responsibility of sales tax collection from outstate catalog marketers should be a separate and distinct issue from that of the determination or collection of corporate state income tax.

Business Community Sentiments

The subject of "Sales Tax collection from outstate marketers" has received numerous comments in previous national

studies from the "business community", many of whom I suspect have Direct Marketers as members.

The members of our Association and many other Retail Associations in other states certainly have no qualms about the "unfairness" that now exists because of the 1967 NATIONAL BELLAS HESS court decision. Untaxed sales transactions create an unfair competitive price advantage equal to the tax rate of the state the product is mailed or delivered to. Taxation should be equitably distributed amongst the whole. Every dollar spent economically turns THREE TIMES according to economic theory. Every dollar spent with an outstate marketer is THREE DOLLARS not available and lost forever to local and state financial support. That loss should create a sales tax collection responsibility, or "nexus" on outstate catalog marketers. That loss makes this, truly, a states issue.

Without that in-state economic revenue, instate taxpayers are forced to higher tax levels to accumulate needed revenues for state budgets. Someone has to pay the bill. In 1983, North Dakota had one of the highest level of total state tax increases in the nation.

Sales tax on outstate sales is of major significance in North Dakota. Every person who addresses the subject projects revenue loss, or impact, in different manners on a state-by-state basis. And yet, no-one is absolutely certain of actual numbers. Records just do not exist to verify impact.

A May 7, 1984 edition of FORBES magazine quotes Direct Marketers as claiming 14% of all retail transctions and expect-

ing to reach 20% by 1990. In North Dakota, that untaxed 15% of taxable retail sales is $860.294 million dollars a year of taxable economic activity on which our state should be entitled to $34,411,760 in sales tax annually. That may be the nigh side of the spectrum.

Our Association through our own research of common carriers has determined that at least eight of every ten parcels delivered to homes annually in North Dakota by common carriers are mailed from outstate marketers. If each parcel's average value was $100, the sales tax loss impact to our state would be $10.9 million dollars a year. That computation we feel is the low end of the spectrum.

A $100 average should be justified for computation. The FORBES magazine article related that American Express in 1983 sold 2,500 plush fox coats that cost $1,000 EACH through the mail. Spiegel's sold about 500 pairs of $175 sandals. And, IBM reportedly sold 20% of its typewriter production without salesmen or stores.

The North Dakota Retail Association encourages YOUR support for S. 1510 to overturn the BELLAS HESS decision. Now, when all states are expected to assume more and more financial responsibility for services previously the obligation of the Federal Government, Congressional legislation to address the subject will receive enthusiastic support from retailers across our nation. The North Dakota 49th Legislative Assembly has already adopted a formal request of our Congress-

ional delegation, and Congress, to introduce and adopt satisfactory legislation to amend the Interstate Commerce Act, allowing states to require outstate catalog marketers to collect sales tax on ALL transactions.

WE do not want to force outstate marketers out of business, nor suggest unfair treatment of their sales. We don't think that collection of a sales tax on each order will decrease their sales one bit. Certainly, the collection of a 4% or 5% sales tax, for example, by outstate marketers on sales transactions, should not significantly, if at all, affect their total sales. And yet, we do recognize that the bottom line price dictates where a consumer will make a purchase regardless of whether or not a sales tax is included.

Direct catalog marketers may provide many reasons why this bill should not be adopted by Congress. And yet, no segment of the "retail community" has grown as fast and increased its sales at as fast a rate as have Direct Catalog Marketers. If the records of the last eighteen years are allowed to proliferate unchanged, the competitiveness of electronic media buying and telephone 800 numbers will forever diminish any incentive a retailer ever had to maintain a displayable, feelable inventory. If Direct Marketers continue to replace the American storefront, our nations unemployment levels will know no bounds, for there may not be mainstreet employers to provide jobs and livable incomes to wage earners, our neighbors and friends.

I ask your help. We must do everything we can to support S. 1510 in Congress to amend the Interstate Commerce Act and overturn the BELLAS HESS case decision.

We must correct this terrible injustice and inequity.

"Thank you" very much for the privilege of appearing before you!

STATEMENT OF J. BASIL WISNER, CHIEF DEPUTY COMPTROLLER, OFFICE OF THE COMPTROLLER, STATE OF MARYLAND; AND PRESIDENT OF THE NATIONAL ASSOCIATION OF TAX ADMINISTRATORS, ACCOMPANIED BY LEON ROTHENBERG, EXECUTIVE SECRETARY, NATIONAL ASSOCIATION OF TAX ADMINISTRATORS; GARY CLARK, ASSISTANT DIRECTOR OF ADMINISTRATION/TAX ADMINISTRATOR, DEPARTMENT OF ADMINISTRATION, DIVISION OF TAXATION, STATE OF RHODE ISLAND

Mr. WISNER. I will be brief, Mr. Chairman, to avoid repetition. I am this year president of the National Association of Tax Administrators, an organization of the 50 State tax agencies. The State tax agencies strongly support the objective of S. 1510. The vast growth in mail order sales through TV cable advertising and the use of the 800 Watts telephone lines, credit cards, and so forth, has created a State revenue loss, which has already been given to you in prior testimony. One thing I will add in my testimony is that NATA has drafted model legislation in this area which addresses such issues as a statutory uniform State and local sales tax rate and the questions that were raised because then the vendors would only have to deal with 46 separate rates.

We also in our legislation recommend a de minimis threshold in order to relieve small firms from financial burdens. NATA shares the view of the Advisory Commission on Intergovernmental Relations, the National Governors Association, and the National Conference of State Legislatures that, without such legislation as S. 1510, the sales tax, which produces one-third of State tax collections, would be seriously threatened as a principal source of State government financing.

We thank you very much for being here today.

Senator CHAFEE. All right, and thank you, Mr. Wisner.

[The prepared written statement of Mr. Wisner follows:]

NATIONAL ASSOCIATION OF TAX ADMINISTRATORS
444 NORTH CAPITOL STREET N.W. WASHINGTON D.C. 20001

STATEMENT PREPARED BY THE NATIONAL ASSOCIATION OF TAX ADMINISTRATORS FOR PRESENTATION TO THE SENATE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT AT ITS HEARING ON S.1510, A BILL TO ELIMINATE THE RESTRICTIONS ON STATES' POWERS IN TAXING SALES IN INTERSTATE COMMERCE

I am J. Basil Wisner, Chief Deputy Comptroller, Office of the Comptroller, State of Maryland. This year, I also serve as President of the National Association of Tax Administrators, an organization of the state tax agencies of each of the fifty state governments.

I express the appreciation of the National Association of Tax Administrators to the Committee for its invitation to discuss with you the states' concerns over the major interstate tax evasion problems which S.1510 addresses.

S.1510 would resolve a major problem in state tax administration and state government financing. The state tax agencies strongly support the objective of S.1510. S.1510 would terminate a huge state revenue loss and it would place local business and interstate business on an equal footing with respect to the payment of state and local sales and use taxes. Without such legislation, the state revenue loss would continue to grow and a major competitive disadvantage now burdening local business would intensify.

The states' concerns are embodied in a resolution adopted unanimously by the National Association of Tax Administrators at its 1985 annual meeting, which accompanies this statement. This statement,

in brief form, assembles information which may be helpful to you in evaluating the need for legislation such as S.1510 and the form in which it may be enacted.

The National Bellas Hess Decision

The state and local governments' huge sales and use tax revenue loss and local competitive disadvantage arise from a 1967 U.S. Supreme Court decision, National Bellas Hess v. Illinois Department of Revenue, 386 U.S. 753, 87 S. Ct. 1389. The Court, in a 6 to 3 decision, ruled that Illinois could not require an out-of-state mail order company to collect sales and use taxes when its only activity in the state was the mailing of catalogs and advertising flyers and the delivery of ordered goods by mail or common carrier. The Court based its ruling essentially on two points: (1) its view that the company received no benefits given by the state in return for collecting and remitting the tax and (2) the need to collect use taxes imposed an undue burden on the free flow of interstate business.

The dissenting opinion held that the out-of-state seller derived benefits through continuous solicitation and exploitation of the Illinois consumer market, that the compliance burden on the out-of-state seller was no greater than the burden on mail order firms located in the state, and that excusing the out-of-state seller from the use tax obligation penalized retailers located in Illinois.

The majority decision has been criticized both for its reasoning and its results, and it has been suggested that the present Court would decide the case differently. Proponents of the states' position have asserted that nexus should not depend on the presence of personnel engaged in soliciting, but that the connection between the out-of-state seller and the taxing state should be an economic rather than a physical relationship. At the time of the National Bellas Hess decision, it was predicted that the case would provide the impetus for a growth in mail order operations which provide an opportunity for the evasion of sales and use taxes. This growth has materialized beyond expectations, and substantial further growth is indicated.

Impact on States

The National Bellas Hess decision, in practical effect, deprived the states of their ability to collect use taxes on sales by out-of-state vendors with no physical presence in the state. The use tax which complements state tax laws is an essential element of sales taxation in that it imposes the same tax on a resident's purchases from outside the states as is imposed on similar purchases in the state. A state which did not impose a use tax would discriminate against its own vendors and would, in practical effect, invite its residents to avoid sales taxes through out-of-state purchases.

Yet despite the critical role of the use tax in effective sales tax

enforcement, the states--because of National Bellas Hess--are unable to collect use taxes from a large and growing number of residents who incur use tax liability through out-of-state purchases. This results from the fact that the states cannot identify such purchases and, even if they could, the cost of collecting tax from each non-reporting individual would be prohibitive. If the states cannot require mail order firms and other out-of-state venders with no physical presence in the state to collect use taxes, then the taxes due on such transactions are not collectible. Under the National Bellas Hess decision, the states have reluctantly had to accept such revenue losses.

In 1967, when the Supreme Court decided this case, the mail order activity relieved from the use tax collection requirement was relatively small. This activity has grown vastly in recent years, as have sales made through TV cable advertising, credit card advertising, and computer communications. The Advisory Commission on Intergovernmental Relations, this year, has estimated state revenue losses at more than one billion dollars annually.

This amount is expected to grow sharply in the coming years, in accordance with announced plans for a continued expansion in the mail order and other direct marketing business. Without federal legislation, state fiscal observers foresee a time when the availability of goods from outside the state on which taxes can be evaded is so extensive as to threaten the stability of this essential source of state revenue.

Impact on Local Business

The state revenue losses due to National Bellas Hess have been accompanied by a loss of local business within the state to out-of-state vendors. State and local sales tax rates now range to a high of more than 8 percent. In a dozen states, state rates alone, or combined state and local rates, are 7 percent or more, and in virtually all, they equal or exceed 5 percent.

In these states, local businesses are confronted by the need to compete with out-of-state direct marketers who can sell goods at effective prices that are from 5 to more than 8 percent below local prices without affecting their profit margins. There are reports from local retailers throughout the country of significant losses of business due to their inability to compete with the sales tax advantage enjoyed by their out-of-state competitors. The loss of local business is necessarily translated into a loss in sales tax revenue in each of the affected states.

In addition, out-of-state vendors with no physical presence in the taxing state also enjoy a competitive advantage over mail order firms which have retail outlets in such states. In 1944, the U.S. Supreme Court in General Trading Co. v. State Tax Commission, 322 U.S. 335, 64 S. Ct. 1028, ruled that the states could require the collection of use taxes by out-of-state vendors with a physical presence in the taxing state. Thus, such companies as Sears and J.C. Penney have consistently collected use taxes on their out-of-state sales while mail order firms with no sales personnel in a taxing state were relieved of this obligation by National Bellas

Hess.

Precedents for Federal Legislation

The problems arising from the National Bellas Hess decision are wholly federal in origin in that they result from interstate activity which the states cannot control under existing law. There are precedents for congressional action to assist the states in resolving interstate problems which exceed their jurisdictional authority.

Congress has assisted the states by enacting legislation to curb cigarette tax evasion by mail order (15 USC sec. 375-378) and by transportation across state lines (18 USC sec. 2341-2344). It made the transportation of gambling devices accross state lines a federal crime (15 USC sec. 1171-1178), and it declared that the regulation of insurance was a state responsibility in 15 USC sec. 1011-1015. Also, to aid the states in addressing specific problems, Congress has enacted laws related to the interstate movement of stolen property, wagering information and persons seeking to avoid prosecution.

These are a few examples of Congress' recognition that state boundaries and limited state jurisdiction create problems which can be resolved only by federal action. The need to curb interstate sales tax evasion and protect state revenues fits into this category.

Form of Legislation

At the request of the state tax agencies, NATA, during the past year, has undertaken to draft a model bill which, like S.1510, would give the states the authority to require out-of-state vendors to collect use taxes on sales into a taxing state.

The NATA bill is currently being reviewed, and it may be changed in several respects. Copies of the bill have been made available to the Committee to indicate the principal areas the states have examined in developing such legislation. Among the matters addressed in the NATA bill are the establishment of a uniform state-local tax rate in each state, to be applied to interstate sales (a measure designed to simplify compliance) and a sales threshold (a de minimis rule). Under the latter provision, in order to avoid burdening small firms, vendors with sales below the statutory threshold would not be required to collect use taxes. The NATA bill, in its original form, contained a state threshold but not a national threshold. A national threshold will be included in the revised version.

Summary

NATA joins with the Advisory Committee on Intergovernmental Relations, the National Governors' Association and the National Conference of State Legislatures in expressing support for expanding state taxing authority to permit requiring out-of-state vendors to

collect state and local use taxes. In a period when many states are confronted by serious fiscal difficulties and when federal financial assistance to state and local governments is being diminished, the need for effective state tax systems is of primary importance to the operation of state government. Sales tax revenue accounts for one-third of state tax collections. It is the view of state tax agencies that without legislation such as S.1510, this vital source of state financing will be seriously threatened if the growth in mail order sales is not accompanied by a requirement that state sales and use taxes be paid on such sales.

RESOLUTION UNANIMOUSLY ADOPTED AT THE FIFTY-THIRD ANNUAL MEETING OF THE NATIONAL ASSOCIATION OF TAX ADMINISTRATORS, HELD IN RENO, NEVADA, JUNE 9-12, 1985

SEVEN

WHEREAS, the effectiveness of a sales and use tax statute depends upon full compliance by all businesses making taxable sales within a state, and

WHEREAS, many nonresident mail-order and direct sale businesses are making taxable sales within states without the collection of the applicable state sales and use taxes, because the states have no legal basis with which to require such businesses to collect tax, and

WHEREAS, such sales are growing in magnitude and have an adverse impact on the licensed businesses which are collecting and remitting the states' sales and use tax, and

WHEREAS, the collection of sales and use tax upon all taxable sales is of great importance to the economic well-being of any state funded by sales and use taxes, and

WHEREAS, lost revenues must be recouped through increased taxation of those already taxed or result in a diminution of services provided by the state, and

WHEREAS, federal funds to states have been reduced, increasing the need for states to depend on their own resources, and

WHEREAS, at the current rate of increase, it is anticipated that by the year 2000 an estimated 25 percent, or more, of sales and use tax revenues will not be collected because local merchants will lose sales to nonresident mail-order and direct sale businesses which do not collect the applicable state tax if action is not taken to enable the state to enforce the collection of tax on sales by nonresident mail-order and direct sales businesses, and

WHEREAS, the passage of this legislation will equalize the tax burden on all residents within states funded by sales and use taxes, now, therefore, be it

Resolved, that the National Association of Tax Administrators endorse its committee's draft legislation to overturn National Bellas Hess and respectfully recommend to Congress that it introduce, consider, and enact said legislation which will prevent huge revenue losses to the states and remove the competitive advantage enjoyed by out-of-state business.

Senator CHAFEE. I would like to ask you and Mr. Rothenberg a question. Obviously, the principal problem here—assuming that the constitutional one can be overcome which I think it can—are the mechanics. I share Mr. Glazer's concern about the burden that is imposed on the direct marketeer. What would you think about a proposal that had a uniform rate and uniform exemptions? For example, maybe you would have to drop down to the minimum imposed by a State. Now, some have no sales tax; we recognize that, whereas some have 4 or 5 or 6 percent.

Let's suppose there is no sales tax in any State that is less than 5 percent. Is that correct? Who would know?

Mr. WISNER. About 5 percent would be the minimum. The average is about 5 or 5½ to 6.

Senator CHAFEE. So, what would you say if you went to a flat 4 percent? Now, my State has 6 percent, so we would be losing 33 percent of the tax. Then, let's say that every State taxes everything but some exclude clothing. I don't know which States do. Do you know, Mr. Martin, what some of the exclusions are, or Mr. Rothenberg?

Mr. WISNER. Some exclusions, in some States, are clothing. Some States exclude market basket items—medicine. Basically, a big thing that might be excluded in this area is clothing. I think that is probably the single item that is not uniform throughout the Northeastern States.

Senator CHAFEE. The problem there, is that, I suppose, a very substantial portion of this is clothing.

Mr. WISNER. A lot of it is.

Senator CHAFEE. Talbott's, Eddie Bauer, and Bedford Fair all sell clothing. So I don't suppose you could go to an exemption in all States of clothing. What I am trying to develop is something simple. Do you have any suggestions, Mr. Rothenberg?

Mr. ROTHENBERG. Senator, most States do not exempt clothing. An exemption for clothing would cut into the sales tax base of the great majority of sales tax States. Food is an extensive exemption. Actually, in the area of general merchandise, exemptions are really not that extensive.

The range of general merchandise is customarily subject to tax, and it has been the view of the tax administrators that, with the computer, those exemptions do not constitute an insurmountable compliance burden. In effect, with the computer, it may be a relatively simple matter to adjust for the differences in the State tax bases.

Senator CHAFEE. Including the rates?

Mr. ROTHENBERG. Including the rates if you are dealing with 46 single rates. The introduction of 46 rates into the computer, again, is not a burden of monumental proportions.

Senator CHAFEE. I think we all agree that we have got to have a single rate per State. The tax is going to get bogged down in the communities within the State.

Mr. ROTHENBERG. Yes, sir, and the tax administrators feel strongly about that.

Senator CHAFEE. Now, what about the point Mr. Glazer made of the de minimis item? I think that is worthy of consideration. You have two catalogs come in, side by side, for a man's parka; one is

from Eddie Bauer which is big enough so that the tax applies, and the other is from a small firm so that the tax doesn't apply. What do you say to that?

Mr. ROTHENBERG. The model bill to which Mr. Wisner referred does contain a specific State-by-State de minimis rule. The tax administrators also look with favor on the de minimis rule suggested by the Advisory Commission on Intergovernment Relations, the $12.5 million, which would eliminate from the compliance burden a very large proportion of small marketing——

Senator CHAFEE. What do you say to Mr. Glazer's point?

Mr. ROTHENBERG. Would you refresh my memory?

Senator CHAFEE. He said you have two catalogs coming in. One is from a big fellow and one is from a little direct marketeer. One says: P.S. please add 5 percent to the charge here, and the other says: No tax required. Which one do you buy from?

Mr. WISNER. I don't think the tax necessarily makes the determination. I think it is the quality of the merchandise and the reputation of the firm you are dealing with. I mean, when people want to buy from L. L. Bean, they could probably buy the same item from Sears, Roebuck; but they are probably making the decision with L.L. Bean because of either past business relationships or the quality or the reputation of the firm. I don't think that, at that point, tax becomes the determining factor as to whether I will buy it from one or the other; but it certainly does hurt the local businessman when they do go out of State with the big firms like L.L. Bean.

Mr. ROTHENBERG. If I might add, Senator, our information on the reports we have received from the States is that, whereas the tax may not be the determining factor in whether a person purchases by mail order or not, the margin of tax does permit the mail order firm operating on a discount basis to have that extra degree of price competition.

Senator CHAFEE. Do you think that we should have one standard period for them to hold the tax before they send it? I think I asked that of Mr. Martin. Would you agree with that?

Mr. WISNER. The national tax group agrees to a quarterly return processing to alleviate the burden on some of these businesses, even though the big businesses, like Sears and Wards and so forth, are now reporting monthly in those States. This would be a condition that we would agree to, that is quarterly reporting.

Senator CHAFEE. So, the direct marketeer gets the float anyway?

Mr. WISNER. We want to make it as easy as possible.

Senator CHAFEE. How many States allow a collection fee of 1½ percent?

Mr. ROTHENBERG. About half the States do allow the retailer a collection allowance—about half of the sales tax States.

Senator CHAFEE. Do we have that in Rhode Island? Mr. Clark.

Mr. CLARK. No, we do not, Senator.

Mr. WISNER. This was something that we could not agree on as an association because some States do allow it and some States do not.

Mr. ROTHENBERG. If I might amplify that, the States that do not allow it view the costs incurred by businesses collecting the sales tax as a business expense. They assume that those costs are transmitted to the customer in the price charged for the goods.

Senator CHAFEE. It seems to me that we have got to have uniformity in that, too. Senator Andrews.

Senator ANDREWS. On that line, a local retail establishment has a customer come in; they buy something and pay for it with a MasterCard or a Visa card or an American Express. They pay a fee for the gross amount of that sale.

So, in essence, that local merchant on Main Street is paying a fee on the tax, as well as on the retail price of the goods. Is that not true?

Mr. ROTHENBERG. I believe so. Yes.

Senator ANDREWS. And they don't get back from the State as much as they pay in the fee to that credit card outfit.

Mr. WISNER. That is correct.

Senator CHAFEE. The big problem I am wrestling with here is not the constitutional problem; it is the burden we are imposing on the direct marketeer. Do you have any suggestions for uniformity or how else this should be handled?

Mr. WISNER. Well, you say "burden." We are not asking them to do something that is not already in existence. You know, they are doing it already within the States where they have nexus—where they have a location. I doubt that there are any of them here who are not collecting a sales tax someplace. It is just that they are not collecting the sales tax every place they do business. So, they already have built in the mechanism to collect the tax because, if they are located in a sales tax State—and most of them would be—they are already collecting the tax for that State and any other States in which they might have a physical location.

So, we are not asking them to do something they are not already doing. We are just asking that it be done uniformly.

Senator CHAFEE. What do you say to that, Mr. Glazer? You are in the State of New York; you must collect New York sales tax, and New York City has an additional tax, don't they?

Mr. GLAZER. There are some 70 different taxing districts. I could be wrong; I don't do the work personally. It may be 55; they may have 70 different taxing districts in New York State. Villages and counties can all add their percentage on top of that. It goes as high as perhaps 8½ percent some places in the State.

I am saying this with some reluctance, that is to come forward with the following information, although it is known back home: Four years after installing our first computer, and we are now on our second one valued at a half million dollars or more, we are still calculating the sales tax manually for the State of New York because we can't get the computer to differentiate between gross sales and net sales, the difference where people return goods, sales of various items in various districts.

It is easy for people who do not live with a computer to say, based on advertising, oh, the computer will do it. I suggest that we have any number of people who are employed by our company who have a terminal beside their bed with a modem hooked up to our computer because that thing, like a baby, hiccups at 11 o'clock at night or at 3 o'clock in the morning; and we are so sensitive to our business that, when the computer goes down, we go down. And we are out of business until that computer comes back up again.

It is easy to say the computer will handle it. Four years and hundreds of thousands of dollars after installing that system, it does not properly calculate sales tax for 70 different taxing districts. And I would maintain that there is little difference between collecting for 45 States and 70 districts within the State of New York. At least within the State of New York, the items taxed are all the same; it is only the rate that differs.

Senator CHAFEE. I didn't understand that. You do it now for the 70 different districts?

Mr. GLAZER. That is correct—manually. We cannot get the computer to do it.

Senator CHAFEE. How do you do that? If I order something from Utica and my sister orders something from New York City—there would be a different sales tax for each sale?

Mr. GLAZER. That is correct.

Senator CHAFEE. Now, do we both get the same blank?

Mr. GLAZER. You get the same order blank in your catalog, and there is a line on that blank that says: Please compute the sales tax for your area. You must then have the ability to deal with percentages and multiplication. We have found within the State that——

Senator CHAFEE. Suppose I don't know the sales tax in my area?

Mr. GLAZER. Then, you either put nothing in or you throw a little in for the guys back in Mount Kisco. [Laughter]

Senator CHAFEE. It sounds like a very informal system.

Mr. GLAZER. As I said earlier, Mr. Chairman, when that order comes in—and we have found very few people that seem to "round up"—most of them seem to "round down"—so when that order comes in——

Senator CHAFEE. Couldn't you withhold those funds in some segregated fashion? Obviously, you have to reimburse the 70 jurisdictions.

Mr. GLAZER. That is correct, Senator. We remit the taxes whether we collect them or not and that is exactly what we do. We remit it and we don't collect it. We live with it because it is only one State. To do that process on a 46 taxing district basis, to remit moneys that we cannot collect—practically collect—that is, from an efficiency point of view we cannot collect it—certainly we have the right to refuse the order, but not when it is a $35 order and you have the merchandise sitting in the warehouse. And you would like to turn that piece of merchandise into cash.

You look at the $1.25 or the $0.95 or the $0.55, and you say: We will pay it ourselves. But I would hate to do that for 46 States.

Senator CHAFEE. You mean that the burdens of New York are dissipated by the fact that you have 49 other States that you are dealing with that don't have this problem, or they don't impose that problem on you?

Mr. GLAZER. If I understand the question correctly, I think the answer is yes. I can live with it in one State because I have to live with it. Either that, or my choice is to refuse to mail to residents of the State of New York because they may not remit the sales tax. We hope that most will, and we hope that they can figure out what 8¼ percent or 5¾ percent or 4⅞ percent, using a hand-held calculator or a pencil and carrying it to three digits, will understand.

Most of them, I don't think, do; they just say put in 75 cents on that line and they will probably ship the product.

Senator CHAFEE. Gosh, you have given me an education. I have been a mail order user, but I haven't gotten as sophisticated as most of your customers. [Laughter]

Mr. Rothenberg.

Mr. ROTHENBERG. Senator, I think it should be pointed out that the problem confronted by the 70 special taxing jurisdictions in New York would not arise with the State government proposal. There would just be a single rate that would be observed in New York—one single rate, not 70.

Senator CHAFEE. No, but what he is saying is that that may be true, but you have 45 jurisdictions—or whatever it is—that vary between 4 and 6 or 6½ percent.

Mr. ROTHENBERG. But that means basically we would be dealing with one specific rate. You would not be concerned——

Senator CHAFEE. You wouldn't necessarily be dealing with one national rate; you would be dealing with one rate for the State.

Mr. ROTHENBERG. That is right. Yes.

Senator CHAFEE. Yes.

Mr. WHEELER. Mr. Chairman, if I might add, those 46 OSC 13 different rates. There are some 46 different rates in the United States, so there would only be some 13 different rates applicable on the order blank, unless you had a nationally universal rate.

Senator ANDREWS. In other words, you are saying that you would have 13 rates across the Nation; and in Rate A, you would list the two or three States that had that rate, and in B, you would list the seven or eight States that had that?

Mr. WHEELER. Absolutely, Senator.

Senator ANDREWS. So, actually, Mr. Glazer would benefit because, instead of monkeying around with 70 rates, he would get down to only 13. We are helping him with this legislation.

Mr. WHEELER. Except in the State of New York.

Senator CHAFEE. Mr. Glazer is able to contain his enthusiasm. [Laughter.]

Mr. GLAZER. I knew there would be a bright side to the trip down here.

Senator CHAFEE. Let me just wind this up. First of all, we thank all the witnesses for coming. Senator Mitchell and I will work with Senator Andrews on another date for a hearing, and it will probably be on a Friday.

I will tell you a little story. When I was Governor, the sales tax rate was 3 percent. When I raised it to 3½ percent, people bitterly complained that they couldn't do the arithmetic; it was too complicated. So, I immediately made it 4 percent. [Laughter.]

I subsequently made it 5 percent, and that seemed to satisfy everybody.

Senator ANDREWS. That is when you left Rhode Island and came down here. [Laughter.]

Senator CHAFEE. Thank you very much.

[Whereupon, at 12:45 p.m., the hearing was adjourned.]

[By direction of the chairman the following communications were made a part of the hearing record:]

STATEMENT OF SENATOR THAD COCHRAN

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

S. 1510

November 15, 1985

Mr. Chairman, I want to commend you and this subcommittee for holding hearings on proposals that would eliminate restrictions on the taxing power of States to impose and collect sales and use taxes on interstate mail order sales.

I am a cosponsor of S. 1510, which would give the states congressional authority to tax mail order sales. This legislation would correct a significant disparity in the application of state and local taxes which currently exists, and would provide a more uniform system of taxation to promote competitive equality for all business enterprises.

State governments are becoming increasingly concerned about their inability to collect sales and use

taxes owed on out-of-state mail order purchases by their residents. In 1967, the Supreme Court held in the National Bellas Hess case that, without congressional guidance, a state could not require an out-of-state mail order vendor to collect and remit the state's sales or use tax on sales made to customers in that state if that firm did not meet a "minimum linkage" or "nexus" test in the taxing state.

However, because of increasing use of toll-free numbers, sales through computers, television ads and other advancements in the retail sales market, state tax administrators view these mail order purchases as posing increasingly serious equity problems for state tax bases and revenues. The mail order market has grown from millions of dollars of sales in the 1960's to $60 billion in 1984.

Like most poor states, my own State of Mississippi depends heavily on the general sales tax as a source of state revenue. Nearly 50 percent of the revenues which go to support primary, secondary and higher education, health, welfare, corrections, and the operations of government, comes from our general sales tax. Currently, about $440 million in general sales tax collections are derived from items which could easily be

sold through interstate sales---sales which would escape taxation.

The National Association of Tax Administrators estimates that 25 percent of all retail sales may soon take place through some sort of interstate transaction. Under this estimate, the State of Mississippi faces a potential loss of 10 percent of the total tax revenues from all sources into its general fund.

At a time when the economic base of our States and municipalities is shrinking, it is important that Congress provide state governments with a method of collecting all revenues to which they are entitled. Significant changes have occurred in the composition of the retail sales market since the National Bellas Hess case was decided 18 years ago. There is no doubt that the increase in mail order sales has diverted sales from local businesses who contribute services, convenience, property taxes, and charitable efforts to their communities. It is time that Congress recognize this tax inequity facing our States, and act to give States the authority to correct the problem.

I thank the Chairman and the Subcommittee for the opportunity to be heard on this matter, and I urge your favorable consideration of this legislation.

STATE OF NEW YORK
DEPARTMENT OF TAXATION AND FINANCE
ALBANY, N.Y. 12227

RODERICK G. W. CHU
COMMISSIONER OF TAXATION AND FINANCE
PRESIDENT, STATE TAX COMMISSION

November 13, 1985

The Honorable John Chafee
Chairman, Senate Finance Subcommittee
on Taxation
SD-219 Dirkson Senate Office Building
Washington, D.C. 20510

Dear Senator Chafee:

I was just informed that your Subcommittee on Taxation is holding a hearing on Senator Mark Andrews' proposed legislation (S-1510) on Friday, November 15. While I would very much like to testify at this hearing, prior commitments make it impossible. I would, therefore, like to submit the attached written testimony for consideration by your Subcommittee. The time constraint of c.o.b. today for submission of this written testimony mandates that earlier testimony on the same subject to the Advisory Commission on Intergovernmental Relations, drafted on March 8, 1985, be my testimony to your committee.

I consider this testimony apropos for consideration by your Subcommittee and extremely pertinent to the legislation submitted by Senator Andrews. The Bellas Hess constraint continues to cost the states much needed revenue and to provide an unfair advantage to those retail merchants that collect and remit the taxes due and owing the States.

Again, let me thank you for the opportunity to submit this testimony for your consideration. I am hopeful that your Subcommittee will aid the states in our effort to promote fair and equitable taxing policies to our citizens.

Sincerely,

Roderick G. W. Chu
Commissioner

Att.

ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS
STATE AND LOCAL TAXATION OF INTERSTATE MAIL ORDER SALES

TESTIMONY BY RODERICK G. W. CHU
NEW YORK STATE COMMISSIONER OF TAXATION AND FINANCE

WASHINGTON, D.C. MARCH 8, 1985

Mr. Chairman, Members of the Commission, honored guests: I wish to express my appreciation for being given the opportunity to speak before this Commission. I consider the topic being discussed to be one of major importance to New York State and, in fact, of major importance to all of the states.

CURRENT SITUATION

As you may know, the court in the National Bellas Hess decision sharply undercut the sales tax revenue base of the 50 states by limiting each state's ability to impose its sales and use tax. We are now permitted to impose our sales tax requirements solely on vendors who have a physical presence in our state. Where a vendor does not have a physical presence, a state can only require that resident consumers pay a compensating use tax on their purchases.

In our system of voluntary tax compliance, tax administrators are required to ask each of our residents to voluntarily come forward and report the use tax they owe on such purchases. Regrettably, enforcement of the use tax is one of the great unsolved problems of tax administration: How can I as a tax administrator determine that John Doe purchased a shirt by mail order from L.L. Bean? Since I do not now have the right to conduct an audit of mail order firms not present in my state, I cannot acquire the names and addresses of the consumers who received shipments of goods in New York. As you can imagine, without an effective means of enforcement, consumers do not comply very extensively with the law. The voluntary payment of use tax for mail order purchases from New Yorkers amounts to less than $20,000 in taxes a year.

In order to deal with the Bellas Hess constraint, I might try to persuade the tax officials in the home state of a vendor to conduct an audit of the company and supply me with the names and addresses of customers in my state. Such an effort would require my sister states to expend substantial resources in getting information for my state while not producing any additional revenue for their own states' treasuries. In addition, with more than 5 million vendors in the United States and 16 million New Yorkers, this represents an incredibly difficult means of collecting these taxes.

IMPACT

The impact of this loss of revenue is severe, especially in light of the trend over the last several years of the federal government reducing grants and aid to the states and municipalities. There seems to be little doubt that this trend will continue and perhaps

dramatically accelerate. I am sure that you are all aware of the tremendous pressure this is bringing on both the states and municipalities in forcing them to consider new taxes and raising taxes which currently exist.

In light of this fact, it is ludicrous that we permit the National Bellas Hess decision to stand and thus make it impossible for the states to fully collect their sales and use taxes. As a result of the Bellas Hess decision, lost revenue to the states has been placed at between $668 million and $1.57 billion from mail order sales.

As large as this loss is, it does not represent the total loss incurred in interstate sales. A recent joint State/City audit of jewelers and furriers in New York City discovered that sales tax was being collected on less than 2 percent of jewelry and fur sales over $10,000. We discovered that even the most prestigious of stores on Fifth Avenue were sending empty boxes to other states in order to evade payment of sales tax. It is clear that the states are losing hundreds of millions of dollars more through such evasion -- evasion which could be curbed through countering the Bellas Hess decision.

But loss of tax revenues is not the only problem caused by the situation we face with interstate sales. The business community faces a problem with competitive unfairness in the marketplace. Sears Roebuck, Montgomery Ward, J.C. Penny and other national stores are required to collect sales tax on their catalog sales made into virtually all 50 states. Why should some other firms have an unfair business advantage of being able to compete with those stores by not having to collect sales tax. In the State of New York, the "discount" (as it were), which such a firm could offer solely on the basis of not taxing the sale, would amount to as much as 8 1/4 percent. To force any firm to compete under these conditions is ridiculous.

Yet, the problem is not isolated to these large, national business establishments. The small businesses in each of our states face a similar unfair disadvantage in trying to attract consumers who must pay the sales tax, when those same consumers can avoid sales tax and easily evade use tax by shopping with mail order establishments or crossing state lines and having merchandise shipped to them at home.

Why then do we penalize the reputable and law-abiding businesses who operate within our borders by permitting such a miscarriage? The reason escapes me and I think it is time we corrected it.

Another concern which may be even more compelling is that the Bellas Hess decision is influencing the citizens of each state to violate the laws of that state. Imagine the temptation to the average citizen purchasing a product through a catalog operation which does not collect the sales tax, not to report that tax. The correct thing for the citizen to do in such a situation would be to voluntarily fill out a use tax form and submit it with the tax to the state in

which he or she is a resident. The temptation to evade this tax is seductive, and there is little doubt that these taxes will not be collected unless the states are able to prove to the public that the tax law can and will be enforced.

We are drawn to the conclusion that the Bellas Hess decision is encouraging the citizens of the United States to perform illegal acts. While I am not versed in criminology, what little I have read on the subject leads me to believe that major crimes are precipitated by other crimes in graduated degrees. Why then do we wonder why we suddenly have a $100 billion federal problem with the "underground economy," with over-zealous methods of sheltering from taxes and with a plethora of schemes designed to defraud the federal, state and local governments out of taxes which are rightfully owed? Bellas Hess is not, of course, the only reason, but it is a wrong that should be corrected, and I am hopeful that it will be.

SOLUTION: LEGISLATION

In order to address this problem, the Executive Committee of the National Association of Tax Administrators last June appointed me Chairman of a committee charged with designing federal legislation to counteract the Bellas Hess decision. This legislation, which is currently in draft form and in a clearance process with the 50 states, is in close accord with the major findings of the Holley H. Ulbrich draft report on State and Local Taxation of Interstate Mail Order Sales which was recently prepared for this Commission. My committee was composed of representatives of the states of California, Washington, Massachusetts, Pennsylvania and New York and had significant input from many other states. The conclusion of the committee was that federal legislation is vital to counteract the Bellas Hess decision. This legislation will contain several key provisions.

- The responsibility to collect and pay sales and use taxes would be expanded to include out-of-state vendors who do substantial advertising or other solicitation of customers in a state on deliveries made into that state.

- A de minimis rule is provided to guarantee that small businesses and businesses selling nominal amounts of goods into a state are not burdened with tax collection and filing requirements.

- In an effort to reduce the administrative burden on business, only one tax rate for each state would be applied. This rate would be the state rate plus the lowest common local rate or a state legislated statewide local rate.

- To further reduce confusion and bookkeeping difficulties, the vendors newly included under this provision would report taxes on a standard quarterly basis nationwide.

- The requirement to collect and pay over taxes to the states would be applied only on a prospective basis for these vendors.

- Finally, the expanded definition of taxable nexus would apply only to sales and use taxes and not to the states' income or franchise taxes. In other words, we are divorcing this issue from unitary taxation of corporations.

As I indicated earlier, my committee is currently consolidating the opinions of the 50 states on what should be contained in federal legislation to counteract the Bellas Hess decision. I earnestly solicit the expertise and support of this Commission in the evaluation of our material. To the same degree, I offer you my support in what I hope is your endeavor to pursue a federally legislated solution. As the conclusions I have read to date from your report are in total agreement with the conclusions of the NATA Committee on National Bellas Hess, I see no reason why this legislation should not be one and the same.

I thank you again for the opportunity to put my and my sister states' perspectives on this problem before you. I am grateful for your consideration of this issue and look forward to your timely and enthusiastic support.

Thank you.

Model Bill Prepared by the NATA Committee on National Bellas Hess Legislation, Roderick G.W. Chu, Chairman.
(Approved by the National Association of Tax Administrators at its Fifty-third Annual Meeting on June 12, 1985)

FEDERAL INTERSTATE TAX BILL

Bill	Comments

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SEC. 101 SHORT TITLE

This act may be cited as the "Interstate Sales and Use Taxation Act of 1985."

SEC. 102 Findings: Purpose

(a) The Congress finds that:

(1) State and local governments are dependent upon sales and use taxes to fund vital governmental services;

(2) Interstate sellers who systematically exploit a jurisdiction's market benefit from the governmental services provided by such jurisdiction;

(3) Significant amounts of interstate sales are escaping sales and use taxation because of the difficulty involved in requiring sellers who systematically exploit a jurisdiction's market to collect that jurisdiction's sales and use taxes from purchasers;

Bill

(4) The inability of states to require collection of sales and use taxes from sellers who systematically exploit a jurisdiction's market threatens the ability of the state and local sales tax system to fund vital governmental services necessary to maintain interstate markets, and provides an unfair competitive advantage to interstate sellers over intrastate sellers.

(b) The purpose of this act is to promote commerce among the states by:

(1) Providing a simplified system whereby states may require interstate sellers to collect state and local sales and use taxes; and

(2) Establishing a uniform standard for determining when it is fair to require interstate sellers who systematically exploit a state or local jurisdiction's market to contribute to the support of that market by collecting sales and use taxes on sales with a destination in such state or local jurisdiction.

SEC. 103 Jurisdictional Standard

Collection of State Sales and Use Taxes. (a) A state shall have the power to require a person to collect a state sales or use

Comments

This section grants to the states expanded authority to require the collection of state sales or use tax. Such expanded jurisdiction

57-404 O - 86 - 6

Bill

tax with respect to sales and uses of tangible personal property and services if (1) the destination of the sale is in that state and (2) that person engages in regular or systematic solicitation and exploitation of a consumer market in that state.

Comments

will apply to person who engage in regular systematic solicitation and exploitation of the consumer market in the state. (This standard for the expanded jurisdiction to require collection of tax is derived from the opinion of the dissenting justices in the U.S. Supreme Court's decision in National Bellas Hess v. Dept. of Revenue (1967) 386 U.S. 753.)

A person becomes subject to the state's jurisdiction with respect to its total operations even though it might solicit and exploit a state's consumer market only with respect to a single product line or division.

This expanded jurisdiction is additional to and does not limit nor effect the authority of the states to subject persons otherwise legally subject to their jurisdiction to collection responsibilities. (See bill § 107(a)) While the grant of additional authority to the states is broad, a limitation of applicability to small business is provided. (See bill § 104) Collection of the state sales or use tax may only be required if the tax is uniform as to rate and base in all geographic areas of the state (definition bill § 106(e) as applied to section 103).

Other Pertinent Cross-references—

Bill § 106 - definitions

Bill

(b) Collection of Local Sales and Use Taxes. (1) Subject to the provisions of paragraph (2) of this subdivision, a state or a local jurisdiction thereof shall have the power to require a person required to collect a state sales tax pursuant to subsection (a) of this section to collect a sales or use tax imposed by a local jurisdiction of such state or imposed by such state on behalf of such local jurisdiction if the destination of the sale is in such local jurisdiction.

(2) A state or any local jurisdiction thereof may not require a person required to collect a state sales and use tax solely by reason of subdivision (a) of this section to collect a local sales or use tax unless:

(A) all such local sales or use taxes sought to be collected pursuant to subdivision (b)(1) of this section are imposed at the same rate on the same transactions in all geographic areas of the state,

(B) all such local taxes are to be collected and administered by the state, and

Comments

Bill § 105 - limitations on frequency and filing of returns

This section provides that persons who become subject to a requirement to collect state sales or use tax may also be required to collect local sales and use taxes. (See following bill § 103(b)(2) for limitations on the collection of local taxes.)

Before a state may require the collection of local sales and use taxes the (1) rate and base of the local sales and use taxes must be uniformly imposed throughout the whole state, (2) seller may not be required to geographically account for its sales to varying localities, and (3) taxes must be collected and administered by the state.

Coupled with the provisions concerning limitations on the frequency and filing of returns (bill § 105), the proposed bill's scheme is such that a single return is to be filed with the state administration in reporting all state and local sales or use taxes

Bill

(C) no person required to collect state and local sales and use taxes solely by reason of this section is required to geographically account for such taxes collected or required to be collected.

SEC. 104 Limitation of Applicability to Small Businesses.

(a) A state may require a person to collect state and local sales and use taxes pursuant to the provisions of section 103 of this act for any calendar year only if, as determined pursuant to subdivision (c) of this section, such person's (1) annual gross sales of tangible personal property and service with a destination in such state exceeds one hundred thousand dollars or (2) annual taxable sales of tangible personal property and services with a destination in such state exceeds twenty-five thousand dollars.

Comments

authorized to be required to be collected.

Other Pertinent Cross-references--

Bill § 106 - definitions

Bill § 107, subds. (e), (f), (g), (h) - relating to savings provisions concerning local sales or use taxes

Businesses having limited sales (less than $100,000 annual gross sales or less than $25,000 in taxable sales) with a destination in a particular state are excused from the requirement to collect and remit state and local taxes. Dual test of gross sales or taxable sales is designed to reflect amount of business activity a business has with a particular state. Thus, a business making significant sales in a state but generating little taxable sales (due to exempt status of the majority of its sales or its purchasers) would be subject to the requirement to collect taxes. The administration burden upon such business is reasonable in view of its extensive, albeit non-taxable, business activity.

Bill

(b) For the purposes of determining applicability of the requirement to collect taxes for any calendar year pursuant to the limitations described in paragraph (a) above, a person shall be deemed to have greater than one hundred thousand dollars in annual gross sales or twenty-five thousand dollars in annual taxable sales with a destination in that state if such person's combined gross sales or combined taxable sales in the four consecutive calendar quarters ending the thirtieth day of September of the year immediately preceding such calendar year of applicability exceed one hundred thousand dollars or twenty-five thousand dollars, respectively.

(c) Any person who pursuant to the provisions of paragraph (b) of this section is subject to the provisions of section 103 of this act shall not be relieved of the responsibility to collect a state's state and local sales or use tax pursuant to section 103 for any calendar year notwithstanding that such person's annual combined gross sales with a destination in that state do not exceed one hundred thousand dollars or annual combined taxable sales with a destination in that state do not exceed twenty-five thousand dollars for the four consecutive calendar quarters ending the thirtieth day of September of such calendar year.

Comments

Applicability of the exception provided in subdivision (a) of this section is determined based upon activity in the state for the four consecutive calendar quarters ending September 30th of the year prior to the year for which collection may be required. Thus, activity in the fiscal year October 1 through September 30 will determine applicability for the next January first.

Cross-reference--Bill § 108(b) - transitional provisions providing for applicability to persons first commencing business in a state.

Persons subject to the requirement to collect taxes pursuant to the Act (§ 104) whose activities in the previous four calendar quarters ending September 30th exceed the threshold limits which would otherwise except these from the collection requirement (§§ 104(a) and (b)) are liable for the collection of the tax for the present calendar year notwithstanding that their activities for the present year fall below such threshold limits. (By operation of the Act, such persons would, however, be excused from the collection requirements in the next succeeding calendar year.)

Bill

(d) A state shall have power to require any person who or which would have been required to collect state and local sales and use taxes but for the provision in paragraph (a) of this section to (1) file an annual information return with such state setting forth the amount of such person's gross and taxable sales with a destination in that state for any year such person makes such sales with a destination in that state and (2) maintain and make available for inspection by such state such books and records of such person as may be necessary to determine the applicability of subdivision (a) of this section to such person, the accuracy of the returns filed or required to be filed, or any of such person's customers who may owe sales and use tax liability to such state.

SEC. 105 Administration.

(a) Return and Remittance Requirements. A state shall only require a person required to collect state and local sales and use taxes solely pursuant to the provisions of section 103 of this act to file a single return reporting and remitting both the state and local sales and use tax collected or required to be collected. Such return may be required to be filed and taxes to be remitted not more frequently than once each calendar quarter and shall be due no sooner than the twentieth day after the last day of such calendar quarter.

Comments

To verify compliance, the states are authorized to require information returns or to audit persons who have activities such that they would be required to collect tax but whose activities fail to exceed the threshold limits.

No more than four returns annually, reporting both the state and local taxes, may be required and such return may not be due earlier than 20 days after the close of the calendar quarter. Since central administration of taxes is required (bill § 103), a person may be required only to file one return reporting state and local taxes.

Cross-reference--Bill § 103 - authorization for collection of state and local taxes only if centrally state administered.

Bill

(b) Credit for Taxes Paid to Other States. A state may not require a vendor required to collect state or local sales and use taxes pursuant to the provisions of section 103 of this act to collect sales and use tax on sales with a destination in that state unless such state allows a credit to purchasers for any sales and use tax previously legally due, and paid, without right of refund by the purchaser, to another state or local jurisdiction thereof with respect to prior liability for the same property or services for the same transaction. Provided, however, this limitation shall not be construed to require a credit with respect to taxes measured by periodic payments made under a lease of tangible personal property imposed with respect to periods other than those periods for which a state seeks to impose liability.

(c) A person subjected to a requirement to collect state and local sales and use tax pursuant to the provisions of section 103 of this act, shall, except as otherwise specifically provided or limited in this act, be subject to all applicable provisions of the sales and use tax laws, rules, regulations and related civil and criminal statutory and regulatory provisions in respect thereto of such state.

Comments

To avoid double taxation, the state must provide for a credit with respect to sales or use taxes legally paid by the purchaser to another state with respect to the same transaction.

Bill

(d) A person required to collect state and local sales and use taxes pursuant to the provisions of section 103 of this act shall keep records of all gross sales of tangible personal property and services and all taxable sales of tangible personal property and services. Such records shall be kept in a manner suitable to determine the correct amount of taxes which should have been collected and shall be organized by state of destination of such sales. Such records shall be available for inspection and examination by state officials charged with the duty of administering the sales and use taxes required to be collected pursuant to the authority of section 103 of this act. All records required to be kept by this subdivision shall be preserved for a period of three years from the last day of the calendar year in which the sale of tangible personal property or service was made.

SEC. 106 Definitions

(a) Sales Tax. A "sales tax" is any tax imposed with respect to and measured by the sales price of the tangible personal property or services with respect to such sale and which tax is required by state law to be stated separately from the sales price by the seller or is customarily stated separately from the sales price.

Comments

This subdivision imposes a uniform record-keeping requirement on all vendors required to collect sales and use taxes pursuant to the provisions of this act. Vendors will be required to keep records of all gross and taxable sales of tangible personal property and services, organized by state of destination of such sales. Such records shall be available to state tax officials upon audit. This uniform record-keeping requirement will assist the states to verify compliance.

Bill

(b) Use Tax. A "use tax" is any nonrecurring tax, other than a sales tax, which is imposed on or with respect to the exercise or enjoyment of any right or power over tangible personal property or services incident to ownership of that property or the leasing of that property from another, including any consumption, keeping, retention, distribution or other use of tangible personal property.

(c) Person. The term "person" includes but is not limited to an individual, partnership, society, association, joint stock company, corporation, estate, receiver, trustee, assignee, referee, any other group or combination (including related corporate entities) acting as a unit, and any other person or agent acting in a fiduciary or representative capacity, whether appointed by a court or otherwise, and any combination of the foregoing.

(d) State. The term "state" means the several states of the United States and the District of Columbia.

(e) State Sales and Use Tax. (1) The term "state sales or use tax" shall for the purposes of this act mean sales or use tax imposed by and administered by the state which is uniform as to rate and base upon identical transactions in all geographic areas of the state.

Comments

Bill

(2) For the purpose of this act, the term "state sales and use tax" shall include a combined state and local sales or use tax where (A) the aggregate rate of such combined state or local use tax is such that the combined rate in any jurisdiction where either (i) local sales or use tax or (ii) both the state and local sales and use tax is imposed is equal to the rate in any jurisdiction where only the state sales or use tax is imposed, (B) the base of such tax is uniform in all geographic areas of such state, (C) such tax is collected and administered by the state, and (D) a person not required to collect a state sales or use tax but for the provisions of section 103 of this act is not required to geographically account for such collections.

(f) Local Sales or Use Tax. (1) The term "local sales or use tax" shall mean a sales and use tax imposed in a local jurisdiction of a state which is uniform as to rate and base with respect to identical transactions with a destination in that local jurisdiction.

Comments

Where local jurisdictions may impose a local tax prompting the whole or a portion of a state sales tax, such tax will be considered a state sales tax provided there is a uniform base, central administration and no requirement of geographic accountability.

Bill

(2) A local sales or use tax includes but is not limited to (A) a sales or use tax imposed in a local jurisdiction of a state by the state on behalf of such jurisdiction and (B) sales or use taxes imposed by a local jurisdiction pursuant to the authority either or both of state and local laws.

(g) Destination of the Sale in a State or Local Jurisdiction. The term "destination of the sale in a state or local jurisdiction thereof" shall mean sales of tangible personal property or services which the seller delivers or causes to be delivered to the purchaser or its agent or designee in that state or local jurisdiction whether such delivery be made by means of the United States Postal Service, common or contract carrier, or otherwise, regardless of (1) whether the purchaser is separately charged the costs of such delivery by the seller and (2) the F.O.B. point or other conditions of the sale.

(h) Engages in regular or systematic solicitation and exploitation of a consumer market in a state. The term "engages in regular or systematic solicitation and exploitation of a consumer market in a state" shall mean and include but not be limited to the regular solicitation of business in that state by (1) the distribution of

Comments

Taxes imposed with respect to a geographically local jurisdiction are local sales or use taxes whether they are imposed pursuant to state law, local law, or any combination of state and local laws.

The activities described herein are generally designed so that mail order houses and border state vendors which entice residents of a particular state to purchase their goods or services will be required to collect tax when such purchases are delivered to the purchaser in that state.

Bill

catalogues, periodicals or other advertising flyers or other advertising by means of print, radio or television media or (2) otherwise soliciting sales by mail, telegraphy, telephony, computer data base or other communication systems whether by cable, telegraphic, telephonic, radio, optic or micro wave, electronic or other means.

SEC. 107 Savings Provisions

(a) Nothing in this act shall be construed to limit a state's (or local jurisdiction's) authority to impose a requirement to collect a sales or use tax upon any person making sales of tangible personal property or services delivered or used in such state (or local jurisdiction thereof) who or which may, regardless of the authority granted such state in section 103 of this act, be required to collect a sales or use tax.

(b) Nothing herein shall be construed to prevent or prohibit any person not otherwise subject to a requirement to collect state

Comments

In addition, to such vendors, the broad language is designed to account for new emerging merchandising techniques such as two-way cable television, shopping at home by computer, etc., and includes vendors utilizing such new concepts within the class of persons who will be required to collect tax.

The bill extends present jurisdiction of the states to require collection of the tax. It does not limit the state's jurisdiction over those persons who, absent the expanded authority provided in the proposed legislation, are subject to the state's authority.

Cross-reference

Bill § 107(b) - persons may voluntarily subject themselves to a state's jurisdiction.

Bill § 107(c) - states may apply the less strict requirements of the proposed legislation to person over whom they otherwise have jurisdiction regardless of the authorization provided in the Act.

Persons may, regardless of the authorizations and limitations applicable to their activities provided in the proposed legislation,

Bill

sales or use tax or local sales or use tax from voluntarily registering with or otherwise voluntarily subjecting itself to any or all of a state's state and local sales or use tax requirements.

(c) Nothing herein shall be construed to prevent or prohibit any state from authorizing or imposing upon any person who may, regardless of the authority granted such state in section 103 of this act, be required to collect a sales or use tax, such less burdensome collection and other requirements as are authorized in this act.

(d) Nothing in this act shall relieve a seller from the obligation to remit to any state any sales or use taxes actually collected by such seller.

(e) A state may require the collection of the state portion of any combined state and local sales or use tax even though that state is prevented from requiring the collection of local sales or use taxes by reason of the provisions of section 103(b)(2) if the rate and base of such state tax is uniform in all geographic areas of the state and the rate of such tax is not in excess of the lowest rate applicable to the same transaction in any geographic area of the state.

Comments

voluntarily subject themselves to full state jurisdiction and compliance requirements thereby entailed.

State option to apply the provisions of the proposed legislation including the limitations provided therein (e.g., return and report requirements, geographic allocation, etc.) to persons over whom they otherwise have jurisdiction regardless of the expanded jurisdiction provided in the Act.

Persons who have purportedly or actually collected a sales tax with respect to any transaction, owe such liability to the state and may not use the provisions of the Act to unjustly enrich themselves.

The fact that a state is prohibited from requiring collection of local sales or use tax does not prevent requirement to collect state sales or use tax. Uniform rate and base of state tax is required. Cross-reference—Bill § 106(e) - definition of state sales tax.

Bill

(f) A state may require the collection of local sales or use tax pursuant to the provisions of section 103 of this act even though that state (1) imposes no state sales or use tax or (2) is prevented from requiring the collection of state sales and use taxes pursuant to the provisions of section 103 of this act if such person could but for the provisions of (1) or (2) above have been required to collect a state sales or use tax.

(g) A state may require the collection of state sales or use tax and local sales or use tax pursuant to the provisions of section 103 of this act even though the base of the state tax and the local tax or taxes are not uniform if the state tax meets the requirements of section 103(a) of this act and the local tax or taxes meet the requirement of section 103(b) of this act and such state and local sales and use taxes are substantially similar.

(h) A state shall not be otherwise prohibited from requiring the collection of local sales or use taxes even though such taxes fail to satisfy the requirements of section 103(b)(2)(A) if the tax to be required to be collected by the state is:

Comments

If a state has no state sales or use tax or is prohibited from requiring collection of state sales or use tax (e.g., rate or base is not uniform), it may still require collection of local sales or use tax if such local taxes required to be collected otherwise meet prerequisites of the proposed legislation.

It is not necessary that a state tax and a local tax are uniform as to base. A state may require collection of both if state base is uniform throughout the state and local base is uniform throughout state.

If local sales or use taxes are not uniform as to rate, a state may still require local taxes to be collected provided that (a) a uniform base exists, (b) the rate of tax required to be collected is not greater than the lowest rate imposed for any jurisdiction in the

Bill

(1) uniform as to base in all geographic areas of the state,

(2) the rate of such tax applicable for all geographic areas of the state is not in excess of the lowest rate of tax applicable in any geographic area of the state, and

(3) no seller required to collect tax pursuant to the provision of this act is required to collect tax upon any transaction upon which a seller, otherwise required to collect sales or use tax irrespective of the provisions of this act, would not be required to collect local sales or use tax.

(i) Nothing in this act shall prohibit a state or local jurisdiction thereof from imposing and collecting a use tax from a purchaser or user with respect to the use in that state of tangible personal property or services:

(1) acquired from a person who is not required to collect such a tax with respect to such sale, or

(2) acquired outside that state or local jurisdiction and brought into that state or local jurisdiction by such purchaser or user.

Comments

state and (c) as constitutionally required, no person is required to collect tax upon a transaction if a vendor fully subject to the state's jurisdiction would not be required to collect such tax upon such transaction.

States may still collect use taxes from their residents concerning out-of-state purchases or sales where the vendors are not subject to the requirement to collect tax.

Bill

(j) Nothing in this act shall prohibit a state or local jurisdiction from collecting a state or local sales or use tax from a person who purchases tangible personal property or services if for any reason the seller has not collected the total amount of state or local sales or use tax from such purchaser, whether or not such total amount was required to be collected. The provisions of this subdivision shall not apply if the seller has collected the total amount of tax imposed by a state or local jurisdiction thereof from the purchaser but has failed to remit such tax to the state.

SEC. 108 Transitional Provisions

(a) The business activities, taxable sales, and gross sales of any person in respect of any state for the four consecutive calendar quarters ending the thirtieth day of September of the calendar year immediately preceding the calendar year in which this act shall take effect shall be controlling in determining the applicability of this act and its provisions to such person for such state for the year in which this act shall take effect. Any person to whom the provisions of this act are determined to be applicable pursuant to this subdivision shall be required to commence keeping records as required by section 105(d) on the effective date of this act.

Comments

Customers are not released from their liability to pay tax and the states may collect such tax from customers. Where proper tax was not collected, or was not or could not be required to be collected, a state is not prevented from collecting the taxes properly due from the customer.

A vendor's activities for the previous calendar year will determine applicability of the proposed law for the calendar year for which it shall be effective.

Bill

(b)(1) Any person, not otherwise subject to a requirement to collect state and/or local sales or use tax or to file returns pursuant to section 104 of this act but for the provisions of section 103 of this act, first commencing to solicit or make sales with a destination in a state after the date upon which this act shall take effect shall not become subject to the provisions of this act, other than the record-keeping requirements prescribed by section 105(d), until the next succeeding calendar year, provided, however, that the provisions of section 104 of this act shall be deemed controlling in determining the scope of the applicability of this act to such person for such succeeding calendar year.

(2) A person shall not be considered "a person first commencing to solicit or make sales with a destination in a state" if that person is a successor in interest to another person (A) by way of incorporation, merger, consolidation or divesture, or (B) as a purchaser in bulk, not in the ordinary course of business, of the business assets of such other person, or (C) as a subsidiary or controlled corporation or entity carrying on the business of its parent or controlling entity in which instance such successor in interest shall be deemed to be subject to such provision of this act as apply or would apply to its predecessor.

Comments

New businesses or businesses first commencing to make sales in any state are not subject to the Act in their first year of activity. However, activities in such year will determine applicability of the Act for succeeding years.

Cross-reference--Bill § 108(b) - provides a successor in interest rule to prevent abuses of the limitations provided in this bill.

Prevents persons from perpetually avoiding provisions of this act by annually changing ownership, business format, etc. Successor business will inherit the responsibilities and applicability of their predecessor.

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ERNEST J. DRONENBURG, JR.
CHAIRMAN, STATE BOARD OF EQUALIZATION
MEMBER, FRANCHISE TAX BOARD

November 13, 1985

Ms. Betty Scott Boom
U. S. Senate Finance Committee
Room SD 219
Washington, D.C. 20013

Dear Ms. Boom:

Re: Senate Hearings on S1510, November 15, 1985

I will be unable to attend the hearings on Friday because of pressing business in my state. However, I would appreciate it if you would incorporate into the records of the hearing remarks I made to the Advisory Committee on Intergovernmental Relations.

Most cordially,

Ernest J. Dronenburg, Jr.
Chairman

EJD/ldb

Enclosures

cc: Leon Rothenberg
David Vienna

Statement of Ernest J. Dronenburg, Jr., Chairman, California State Board of Equalization to the Advisory Commission on Intergovernmental Relations, March 8, 1985, Concerning Potential Federal Legislation Overturning the National Bellas Hess Decision.

Due Process Problems in Overturning National Bellas Hess by Federal Legislation

On May 8, 1967 in National Bellas Hess Inc. v. Department of Illinois, 18 L.Ed.2d 505, the United States Supreme Court decided that, since Bellas Hess, a national mail order house, did no more than communicate with customers in Illinois by mail or common carrier as part of a general interstate business, the requirement that Bellas Hess collect and pay the Illinois use tax violated the due process and commerce clauses of the United States Constitution. The tests for determining whether a state tax violates such clauses are similar. As to the interstate commerce clause:

> "State taxation falling on interstate commerce...can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys." (Freeman v. Hewit, 91 L.Ed. 249.)

As to the due process clause, the

> "simple but controlling question is whether the state has given anything for which it can ask return." (Wisconsin v. J. C. Penney, 85 L.Ed. 267.)

In 1967, when Bellas Hess was decided, interstate mail order sales were estimated on a national basis to be 12.9 billion dollars. Since 1967, mail order sales have grown phenomenally. The magazine Direct Marketing recently published a survey showing that, for 1982, mail order sales of consumer and business products and services totalled approximately 66 billion dollars. In California alone, after making allowance for sales on which tax is already

collected by the seller or the purchaser is a business which reports tax directly, our Research and Statistics section estimates our yearly untaxed mail order sales to be 1.9 billion with a tax loss of 120 million.

Given such explosive growth of mail order sales the tax loss resulting from Bellas Hess is never far from the minds of state tax administrators, and federal legislation is seen as the most direct means of reversing Bellas Hess. The usual suggestion is for a federal statute imposing a collection duty on all interstate retailers regardless of nexus or method of ordering and shipping. Hopes for such an all-encompassing collection duty are encouraged by Justice Stewart's invitation to legislation at the end of the majority opinion in Bellas Hess, supra, at page 510:

> "Under the constitution, this is a domain where Congress alone has the power of regulation and control."

Yet hopes for a federal statute allowing an all-encompassing collection duty often overlook Congress' limited power under the due process clause. When then Senator Mondale introduced S2811 (1973), which was the first federal bill proposing to overrule Bellas Hess, the then Chief Counsel of the California State Board of Equalization, Charles H. Otterman, in an April 4, 1975 letter to the United States Senate Committee on Finance, raised the due process clause problem as follows:

> "We still think that the attempt by Section 101(a) to give states the power to subject 'no-nexus sellers' to the responsibility for state tax collection is open to a question of constitutionality under the decisions of the U.S. Supreme Court dealing with due process. Congress clearly may lift barriers to state taxation under the commerce clause, but no case law to date sanctions the legality of legislating due process beyond the limits allowed by the U.S. Supreme Court. This aspect of the bill has received some attention, but since it goes to the very heart of the plan to trade more limited jurisdiction to tax in one area for increased jurisdiction to tax in another area, I think it should be subjected to very thorough legal analysis."

It may still be stated in 1985 that "...no case law to date sanctions the legality of legislating due process beyond the limits allowed by the U.S. Supreme Court". The fate that could await a "no nexus" federal statute, when it faces the inevitable test before the U.S. Supreme Court, may best be seen by the evolution of the state's power to tax interstate insurance contracts.

Originally, during the 75-year period preceding 1944, the U.S. Supreme Court held that the individual States had the power to regulate and tax out-of-state insurance companies even though all aspects of the insurance contracts were conducted across state lines. In 1944, the U.S. Supreme Court startled State tax administrators by deciding in United States v. Southeastern Underwriters, 88 L.Ed. 1440, that the modern business of insurance was interstate commerce and, therefore, could not be regulated or taxed by the States. At the request of the States, the Congress immediately reacted to this restriction on State jurisdiction by passing the McCarren Act, 15 USCA 1011, providing that the regulation and taxation of insurance should be subject to the laws of the States. This, on its face, appears to be the type of carte blanche grant of taxation power to the States that we would like to have over interstate mail order retailers. Unfortunately, the story does not end there.

Seventeen years after this grant of power to the States in the McCarren Act, the State of Texas attempted to tax the premiums paid under an insurance policy covering a risk within Texas issued by Lloyds of London, which carried on no intrastate business within Texas. In State Board of Insurance v. Todd Shipyard Corporation (1962), 8 L.Ed.2d 620, the U.S. Supreme Court held that the tax was invalid because violating the due process clause of the 14th Amendment and that the tax was not saved by the McCarren Act providing that the insurance business would be subject to State laws relating to regulation and taxation. Mr. Justice Douglas stated, at page 624:

> "The power of Congress to grant protection to interstate commerce against state regulation or taxation (citations omitted) is so complete that its idea of policy should prevail."
>
> "Congress, of course, does not have the final say as to what constitutes due process under the 14th Amendment."

Coming forward to California in 1983, in Illinois Commercial Men's Association v. State Board of Equalization, 34 Cal.3d 839, 80 L.Ed.2d 452 (1984), the California Supreme Court decided that California could tax out-of-state insurance companies soliciting business in California by mail from outside California but utilizing independent contractors in California to administer claims. Ironically, the Bellas Hess case is prominent in the court's analysis. We have then, in 1983, our own Supreme Court applying the Bellas Hess standards to decide if we can tax an insurance business even though that insurance business is already admittedly subject to the 1945 federal statutory provision of the McCarren Act that the insurance business is subject to the taxation laws of the States. From this it is clear that a federal statute will not avoid Bellas Hess's Due Process standards for state taxation. And it should be noted here that the Bellas Hess opinion, at page 508, states that the same principles have been held applicable in determining the power of a state to impose the burden of collecting a use tax or to impose a direct tax (insurance tax) on a retailer.

Even if the federal Congress enacted a statute saying that all interstate mail order retailers must collect our use tax, the U.S. Supreme Court has "the final say" as to whether such statute violates due process. If a federal statute imposing a broader use tax collection duty is to pass due process muster in the U.S. Supreme Court, rather than relying only on the dollar volume increase in mail order sales, the statute must be predicated on a greater "presence" by the mail order retailers in the taxing states.

We believe that where there is a regular or systematic solicitation and exploitation of the consumer market in the receiving state, the substantive due process requirement will be met.

A number of factors may be important in determining whether there is systematic exploitation in the receiving state. The factors which may be important include:

1. Locally placed or circulated advertising;

2. Use of locally generated demographic information.

3. Substantial recurring mail solicitation (e.g., mailed to more than 1,000 residences, more than one mailing);

4. Use of in-state credit (bank credit card) or collection facilities;

5. Use of local transportation facilities;

6. Use of local communication facilities;

7. Authorization of local installation, servicing or repair facilities;

8. Maintenance of an in-state retail establishment by a related legal entity engaged in the same or a similar line of business.

In summary, with the development of a national marketplace, it is our conclusion that due process objections can be overcome in those cases where the mail order retailer actively and aggressively exploits that segment of the marketplace located in any one individual state.

Business Cost of Compliance with Proposed Federal Legislation

Opponents of efforts to extend state jurisdiction to tax out-of-state mail order houses often cite the high costs of compliance as a reason for their opposition. While this may once have been a concern for small operations which manually processed orders, it can no longer be considered a major consideration in the debate over whether such businesses should be compelled to collect and remit tax.

First, most proposals for federal legislation as well as the ACIR study contain a threshold point in terms of sales and taxable gross receipts which companies would have to exceed before they became subject to state jurisdiction. This would effectively eliminate the small to middle-sized retailer who does not have sophisticated billing and accounting systems and who might have difficulty gathering the information to collect the proper amount of tax in each state.

The larger mail order firms have larger and more sophisticated computer systems, and the collection of use taxes would not be a great deal more burdensome than the taxes they are already collecting in their home state.

Next, it is claimed that new retailers will be uncertain whether or not they must collect tax, increasing costs for retailers who do collect the tax and later find out that they do not meet the threshold.

The legislation proposed by the National Association of Tax Administrators, however, would allow new businesses to use the first year of operation to determine if their total sales and taxable gross receipts are sufficient enough to subject them to another state's sales and use tax collection requirements.

If the new entity, however, is the result of a merger of two or more retailers, that entity must collect the use tax if any one of the merging retailers was required to collect the use tax prior to the merger. Use of these guidelines eliminates the uncertainty of new retailers as to whether they meet the threshold point.

Nor can the claim that requiring vendors to file information returns if they do not meet the threshold substantially increases compliance costs survive much scrutiny. While it might be difficult for very small firms

to account for taxes due to different states because of different tax rates, it should not be difficult to account for sales and the state they are destined for.

Legislation proposed by the NATA would also minimize the burden of complying with differing state requirements for filing returns, credits and refunds and of applying different rates of tax by requiring:

Standard provisions for filing returns in all states;

Quarterly returns, instead of monthly returns, due twenty days after the end of the quarter;

A single combined return for state and local taxes collected for each state with no geographical breakdown except for local areas above a certain population;

Standard provisions for obtaining credits or refunds from the taxing states;

State sales and use tax be uniform in rate and base throughout the state before a retailer is required to collect the tax;

Local taxes also be uniform in rate and base statewide, except for certain large political subdivisions for which additional taxes might be imposed; and

Geographic allocation of local taxes only on sales delivered into certain large, political subdivisions with populations in excess of a certain amount.

In conclusion, it should be kept in mind that all large mail order houses and most small mail order houses utilize sophisticated, computerized techniques in developing their mailing lists, controlling their inventories and ensuring that their customers receive the products they have ordered. With a minimum amount of effort, those sophisticated, computerized techniques could be modified to substantially reduce the difficulty of collecting and reporting sales and use taxes.

Estimate of Revenue Impact on California

The research department of the California State Board of Equalization has estimated that up to $120 million in use tax revenues in 1984 were not collected as a result of the Bellas Hess decision.

Direct Marketing magazine estimated $90.285 billion in mail order sales and contributions nationally during 1982. Their breakdown is shown below along with the amounts that at least on the surface would represent potential additions to the tax base:

	Total Sales (Millions)	Potential Additions To Tax Base (Millions)
Consumer Products		
General Merchandising		
Big 5 Catalog Retailers	$ 4,425	$ 490
Department/Specialty Stores	2,250	225
Catalog Showrooms	695	69
Oil Company Syndication	540	-
Airline Syndication	20	-
	$ 7,890	$ 784
Specialty		
Animal Care	$ 40	$ 40
Apparel	1,390	1,390
Audio-Video	165	165
Automotive/Aviation	240	240
Books	1,845	1,845
Collectibles	1,035	1,035
Consumer Electronics/Science	350	350
Cosmetics/Toiletries	185	185
Crafts	385	385
Food	555	-
Gardening	580	580
Gifts	860	860
Hardware/Tools	235	235
Health Products	490	490
Home Construction	75	75
Housewares	340	340
Jewelry	265	265
Magazines	3,435	-
Multi-Products	1,460	1,460
Newspapers	5,250	-
Photographic Products	285	285

Records	430	430
Sporting Goods	815	815
Stationery	145	145
Tobacco	25	25
Toys/Games/Children's Products	100	100
Computer Software	200	200
	$21,180	$11,940
Consumer Services		
Astrology/Occult	$ 15	-
Auto Clubs	1,050	-
Cultural Events	400	-
Educational	180	-
Financial	125	-
Insurance	5,500	-
Sports Events	400	-
Home Study	250	-
Cable TV	4,400	-
	$12,320	-
Total Consumer Products & Services	$41,390	$12,724
Business Products & Services	$24,735	-
Charitable Contributions	$24,160	-
GRAND TOTAL	$90,285	$12,724

It was assumed that 12 percent of the total potential additions to the tax base are purchases by Californians, potentially increasing the California tax base by $1.9 billion. At an average state tax rate of 6.26 percent, an additional $120 million in use tax would have been collected in 1984.

The mail order sector has grown rapidly since 1982. A conservative figure of 10 to 15 percent annual growth was used to arrive at the 1984 estimated revenue loss of $120 million.

For most of the categories, it was assumed that either all or nothing would be added to the tax base. This is admittedly a rather simplistic approach that is not totally correct as illustrated by the following:

1. We already collect tax on some of the sales included in the potential increase, since some concerns are either headquartered in California or are doing business there. American Express, Eddie Bauer, and REI are among the more familiar names.

2. No potential pickup was assumed from business products and services on the grounds that most sales would

be to businesses having a sales tax permit. Therefore, California already receives a bulk of the applicable use tax. There are some businesses which are not permitized, and also some firms with permits which do not remit all required tax to the State Board of Equalization.

3. Some firms which appear to be doing business in California are set up as separate entities from the mail order business, and therefore allow the mail order business to escape tax. It may not be completely true, for example, that California collects all potential tax on oil company syndications.

4. Some categories are not as clean as might appear at first. For example, a fruit-of-the-month firm shipping from Oregon, does artificial flowers, too. Moreover, one of the largest "mail order firms" is the U.S. Government which completed $84 million in nationwide sales of collectibles, educational services, drugs and vitamins.

It was assumed that 12 percent of the total potential additions to the tax base are purchases by Californians, potentially increasing the California tax base by $1.527 billion. At an average state tax rate of 6.26 percent, an additional $96 million in use tax would have been collected in 1982.

The mail order sector has grown rapidly since 1982. A conservative figure of 10 to 15 percent annual growth was used to arrive at the 1984 estimated revenue loss of $120 million.

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Mississippi

House of Representatives

Jackson

COMMITTEE ASSIGNMENTS:
Ways and Means, Chairman
Apportionment and Elections
Constitution
Insurance
Judiciary A
Rules

Joint Congressional Redistricting Committee
Joint Legislative Committee on Reapportionment

November 15, 1985

Senator Robert Packwood, Chairman
Senate Committee on Finance
Room 219 Dirksen Senate Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

We appreciate the opportunity to contribute the following remarks regarding Senate Bill 1510 which is currently under consideration by your committee. Senate Bill 1510 would correct a significant disparity in the application of state and local sales taxes which currently exists and would eliminate a source of unfairness in state and local sales tax levies.

Mississippi, like most other states and in particular like most poor states, depends heavily upon the general sales tax as a source of state revenues. In fact, almost 50 percent of the revenues which go to support primary, secondary and higher education, health, welfare, corrections and the operation of government come from our general sales tax. Currently, about $440 Million of general sales tax collections in Mississippi come from items which could easily be sold through interstate sales--sales which would escape taxation. If we accept the National Association of Tax Administrators' estimate that we could approach a point where 25 percent of all retail sales take place through some sort of interstate transactions, the State of Mississippi faces a potential loss of $176 Million per year in general fund revenues. This would represent a loss of 10 percent of the total tax revenues from all sources going to our general fund.

Because of a shortfall in tax collections for the first quarter of the current fiscal year, Mississippi has already had to implement a $47 Million cut in general fund expenditures. Preliminary estimates indicate that revenues will fall short of projected expenditures by more than $100 Million in FY 1987 unless additional cuts are made in the operation of State Government. Additionally, we estimate that we stand to lose approximately

$50 Million in FY '87 and $100 Million in FY '88 from anticipated federal budget cuts. Certainly you can understand why the potential loss of an additional $176 Million in tax revenues is extremely discouraging to us.

Finally, we understand that one item under consideration is to insert some kind of floor in Senate Bill 1510 which would either exempt firms with total sales below a certain amount or exempt sales to a certain state if they fell below some amount. While we understand that a floor for total sales might significantly simplify the administration of the law and might be efficient in terms of the relative costs of collection, we would discourage any floor based upon sales to a particular state because this would allow transactions in larger, wealthier states to be taxable while the sales to individuals in smaller or poorer states would escape taxation; and ultimately those states in the greatest need of the revenue would be the ones that were deprived of the additional income.

We have attached for your further consideration a copy of House Resolution No. 29 which was adopted during the 1985 Session of the Mississippi Legislature which further demonstrates the strong support for legislation such as Senate Bill 1510.

Very truly yours,

H. L. Merideth, Jr.
H. L. Merideth, Jr., Chairman
Ways and Means Committee

C. Robert Montgomery
C. Robert Montgomery, Chairman
Finance Committee

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Enclosure

MISSISSIPPI LEGISLATURE REGULAR SESSION 1985

By: Representative Merideth To: Rules

HOUSE RESOLUTION NO. 29

A RESOLUTION MEMORIALIZING THE CONGRESS OF THE UNITED STATES TO ENACT LEGISLATION ALLOWING TAXING STATES TO COLLECT SALES OR USE TAXES FROM INTERSTATE SELLERS WHO SOLICIT BUSINESS IN THE TAXING STATE.

WHEREAS, the State of Mississippi imposes a retail sales tax on sales of tangible personal property taking place in Mississippi and imposes a use tax on all purchases of tangible personal property acquired from outside Mississippi with first use of such property taking place in Mississippi; and

WHEREAS, the states have been seriously handicapped in their ability to collect legally-due use taxes on interstate sales because of the 1967 U.S. Supreme Court decision in the case of National Bellas Hess v. Department of Revenue of the State of Illinois, 386 U.S. 753; and

WHEREAS, the National Bellas Hess decision denies states the legal authority to require the collection of use taxes by out-of-state mail-order businesses which have no physical presence in the taxing state but which may advertise extensively therein; and

WHEREAS, the National Bellas Hess decision has resulted in a loss of hundreds of millions of dollars in use tax revenue to the states and has placed local businesses and out-of-state retailers with a physical presence in taxing states at a serious competitive disadvantage; and

WHEREAS, the problems of state revenue loss and the competitive disadvantage of local business have been intensified in recent years because of the great growth in mail-order sales

through television, radio and credit card advertising and it is estimated that by the year 2000 one in every four consumer dollars will be spent on mail-order sales; and

WHEREAS, these problems can be resolved only by the correction of the National Bellas Hess decision:

NOW, THEREFORE, BE IT RESOLVED BY THE HOUSE OF REPRESENTATIVES OF THE STATE OF MISSISSIPPI, That we do hereby memorialize Congress to introduce, consider and enact legislation which would prevent this huge state revenue loss and remove the competitive advantage now enjoyed by out-of-state business and that it do so by authorizing the states to require the collection of sales and use taxes by interstate sellers who solicit business in a taxing state through catalogs, advertising materials, radio, television and the press.

BE IT FURTHER RESOLVED, That a copy of this resolution be sent to the President of the United States and the members of the Mississippi Congressional Delegation.

hm
H. R. NO. 29
ACJ.85S1472
PAGE 2 -
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